Safehands Accounting Ltd

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financial UPDATE

Changes to entrepreneurs' relief:

new restrictions on directors

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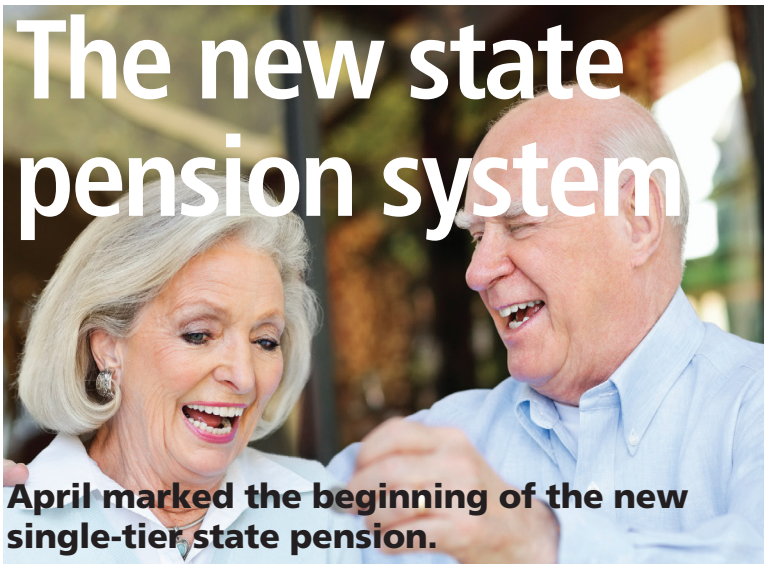
The new state pension system



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April marked the beginning of the new single-tier state pension.

The UK state pension system underwent a seismic change on 6 April 2016. Until then the state pension system had long consisted of two components: a basic state pension (£119.30 in 2016/17) and, for employees only, an earnings-related pension. On top of these two sat the means-tested Pension Credit, designed to guarantee a minimum overall weekly retirement income of £155.60 (in 2016/17 terms).

Unless you reached your State Pension Age (SPA) before April this year, that complicated structure will no longer apply to you. In place of the two state pensions there is now a single-tier pension, pitched at a level just high enough (£155.65 a week maximum in 2016/17) to make the remaining element of Pension Credit largely irrelevant.

You will now need 35 years of National Insurance contributions or credits to earn the full single-tier pension, whereas 30 years were previously required for a maximum basic state pension. If you have a contribution record of fewer than 10 years by the time of your SPA, you will receive no single-tier pension. As a general rule, only your own contribution record counts – you cannot rely upon your spouse's or civil partner's contributions.

Once in payment, the single-tier state pension currently has annual increases based on the 'triple lock' (the greater of 2.5%, CPI price inflation and earnings increases each year), an expensive formula that may be watered down after 2020.

The single-tier reform has been accompanied by a raft of transitional provisions, the most important of which sets a 'starting amount' of pension as at 6 April 2016 equal to the greater of:

- what you would have received under the old rules; and
- the amount you would have got if the new rules had existed when your working life began.

This calculation can produce some surprising numbers, because adjustments are made to allow for the contracting out of the state second pension and its SERPS predecessor. The pensions minister has said that in 2016/17 only 38% of those reaching SPA will receive the full £155.65 a week.

The new regime inevitably creates winners and losers, with losers more common because the scheme's long term cost is less than its predecessor. Broadly speaking, the higher your earnings and the further you are from SPA, the worse off you will be. As part of your retirement planning, it is well worth visiting the government pension projection website (www.gov.uk/check-state-pension) to see how much (or little) you might receive.

Tax on investments: new opportunities

Valuable opportunities have opened up recently to save tax on investments. Some people will now be able to have up to £17,000 of savings income tax free. If they also receive dividends, up to £22,000 of their income could be tax free as a result of the new £5,000 dividend allowance.

There are essentially three main categories of income: savings income, which includes interest on deposits in banks and building societies; dividends; and other income such as earnings, pensions and rent.

Tax rates are applied to different types of income in a defined order and that order can make a difference to the amount of income tax payable. The order for taxing income is: earning and other non-savings first, then savings income and finally dividends.

0% rate band

The 0% starting rate of tax operates in a very specific way but it can be valuable. The maximum 0% starting rate band is £5,000 and is given on your savings income if non-savings income is no more than the personal allowance of £11,000. However, as non-savings income is taxed first,it will not be available at all if your non-savings income exceeds the personal allowance plus the £5,000 starting rate band – that is a total of £16,000.

So if you have of earnings/pension income of up to £11,000, you could receive £5,000 of savings income free of income tax.

Dividend income does not affect your entitlement to the savings income starting rate band because it sits on top of the savings income and is taxed last under the rules set out above. So you might have £11,000 of earnings, £5,000 of savings income and thousands of pounds of dividend income, but you would still qualify for the nil starting rate band and that would mean your £5,000 of savings income would continue to be taxed at nil.

There is also the new savings allowance. For basic rate taxpayers, the allowance means that £1,000 of savings income will be tax free. Basic rate taxpayers could therefore potentially receive tax-free savings income of £17,000 (i.e. £11,000 personal allowance plus £5,000 taxed at 0% starting rate plus £1,000 savings income allowance). For higher rate taxpayers the savings allowance is reduced to £500, so the value of the tax relief given by the allowance is the same whether you are a 20% taxpayer or a 40% taxpayer. But if you have enough income to push you into the 45% tax bracket – even by just a pound – you lose the allowance altogether.

Spread the income

Basic rate tax is no longer deducted at source from interest on bank and building society accounts, etc. In addition, from April this year, the first £5,000 of a person's dividend income is tax free. So it makes sense to ensure that dividend income is spread around a family – where possible – to maximise the benefits of having tax-free income.

Some couples might find that one of them has a relatively low level of earnings/pensions, in which case the lower income partner should consider holding the assets that generate the savings income and dividends to qualify for the extra tax-free cashflow.

Children under 18 – and sometimes even older – generally have relatively low earnings or other non-savings income. Any tax-free savings or dividend income they receive could be really tax-efficient. But don't forget, income that arises from a parental gift will be taxable on the parent if it comes to over £100 in a tax year.

"Sole traders or business partners must have owned the business for at least one year before the date on which they sell it."

Changes to entrepreneurs' relief

Entrepreneurs' relief is important for all business owners, because the capital gains tax (CGT) charge on qualifying assets is only 10%. However, with the rate of CGT on most assets (other than residential property and carried interest) now down to just 20% for higher and additional rate taxpayers, missing out on entrepreneurs' relief has not been quite so serious since 6 April this year.

There is an overall lifetime limit of £10 million on the amount of gains on which you can claim the relief. You can claim the relief as often as you like up to this level.

Several types of assets can qualify for entrepreneurs' relief, including:

- All or part of a business owned by a sole trader or business partner, including the business's assets after it closed.
- Shares or securities in a company where the person making the disposal has at least 5% of the shares and voting rights.
- Shares acquired through an Enterprise Management Incentive (EMI) scheme after 5 April 2013.
- Assets the person making the disposal lent to their business or personal company for the trade.

'Disposal' in this context often means sale but it could mean gift or even the liquidation of a personal company.

An important change made this April to entrepreneurs' relief hit directors who wind up a solvent company. They can no longer claim entrepreneurs' relief if they continue to work in the same trade as the company in the following two years after the liquidation. A record number of solvent companies were wound up in March in anticipation of this change.

This new rule will affect situations where a shareholding director sells the goodwill and other business assets out of their company and then puts the company into liquidation and takes the proceeds as a capital gain taxed at just 10%. In such circumstances, the buyer of the underlying business might well expect the outgoing owner to continue working as a consultant for a changeover

period. Such an arrangement could now present a problem and you should be aware of this possibility when negotiating a deal. It is essential to get advice on this matter.

The business or company being disposed of must be trading in order to qualify for the relief. So most forms of property letting are excluded from entrepreneurs' relief. There can also be complications where a company owns a share in a joint venture with another company. Indeed, there are some changes to this situation in the Finance Bill.

Sole traders or business partners must have owned the business for at least one year before the date on which they sell it. And if an owner is closing their business rather than selling it, they must have also owned it for at least a year before the closure.

The business assets must then be disposed of within three years to qualify for relief.

For a sale of shares or securities, the seller must have been an employee, a director or some other office holder of the company being sold or one in the same group. Furthermore, for at least one year before the sale of the shares, the seller must have had at least 5% of shares and voting rights in the company, unless the shares were acquired through an EMI scheme.

Assets such as property that a business owner has lent to their business may also qualify for entrepreneurs' relief. They must have owned the assets but allowed the business partnership or personal company to use the assets for at least one year up to the date of the sale or the date the business closed.

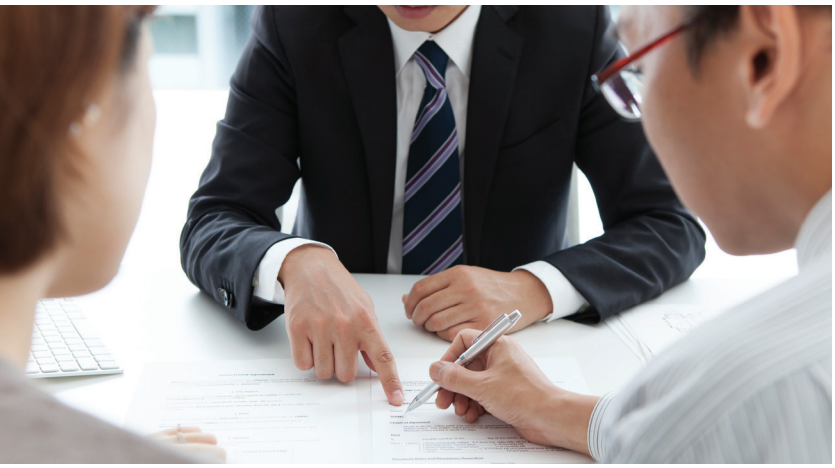
Stamp duty exemption for granny flats

Most granny flats will not now be caught by the new 3% stamp duty surcharge. This exception applies where you buy a separate flat, annexe or even a holiday home alongside the main residence, provided the value of the second property is not more than a third of the total price paid.

So, for example, if a main property is worth £250,000 and a separate annexe is £50,000, the buyer will avoid the 3% surcharge because the annexe is less than a third of the total price.

Loan rates rise for close companies

The rate of 'temporary' tax charged on loans to participators in close companies has been increased from 25% to 32.5% (the same as the highest rate of income tax on dividends), with the increased rate applying to loans made on or after 6 April 2016.



Very broadly, your company will be classed as close if it is controlled by five or fewer participators – usually shareholders – or by any number of participators if they are also directors. But for the close company loan rules, it would be very easy for the company to make tax-free loans rather than paying taxable remuneration or dividends.

The tax treatment of a close company loan can be quite complicated because the employment income beneficial loan rules can apply. The 32.5% charge only applies to participators, whether or not they are directors. However, loans to directors can also be taxed as beneficial loans regardless of whether they are participators.

For example: ABC Ltd, a close company, made an interest-free loan of £50,000 to Andrea, a director/shareholder, on 1 July 2016. The company's year-end is 31 December 2016. The company will only have to pay a 32.5% charge if the loan is outstanding at 1 October 2017 – nine months and a day after the end of the accounting period in which the loan was made, which is also the due date for corporation tax. The company will have to pay tax of £16,250 on that date. However, there will be no charge if Andrea repays the loan by 30 September 2017, provided the repayment is genuine.

For instance, HMRC will ignore any repayment that is followed or preceded by a similar loan within 30 days.

The tax will be refunded if the loan is subsequently repaid or written off. In the example, Andrea will also be taxed on a benefit based on HMRC's official rate of interest. For 2016/17, this will be £50,000 at 3% for 279 days = £1,146. ABC Ltd will pay class 1A NIC on the benefit.

Managing loan accounts

You may think that this does not affect you, but it is surprisingly easy for a director's current account to become overdrawn – this would be treated as a loan. Remember that any personal expenses that have been paid from the company's bank account may be charged to your loan account. A typical strategy would be to cover the debt by declaring a dividend, but this will not be possible if company profits are insufficient – such as when the company has made a loss.

Of course, a director could take additional remuneration instead, but this comes with an NIC cost and the real time PAYE reporting requirements must be complied with. A better approach could be to vote enough salary and/or dividends at the start of the year so that you have funds available to draw upon.

Although it's a good idea to simply avoid overdrawing your personal account, there might be a situation when you really need a short-term company loan. With careful timing, you can make use of company funds for up to 21 months without having to pay the 32.5% charge. And if you have to pay a charge, timing is also important when it comes to repayment. Making the repayment just before the company's year-end, rather than just after, results in a one year earlier tax repayment.

If your spouse or civil partner is also a director and their loan account is in credit, then that balance could be used to offset your overdrawn account. However, for this to work, the two accounts must effectively be operated jointly.

The importance of checking PAYE codes

This year, there are more reasons than usual why your PAYE code could be incorrect. For example, if you are a company director, HM Revenue & Customs (HMRC) might have coded out the estimated tax on your dividends rather than waiting for you to pay the tax on the 31 January 2018 deadline. However, HMRC will have based the estimate on your income for last year before the tax rules changed. Interest is now paid gross, so HMRC may also have included this in your coding – even if it is covered by the tax-free savings allowance. You can, of course, have dividends or interest removed from your PAYE code.

Implications of Brexit for tax and business

The vote to leave the European Union has triggered a period of uncertainty for the UK economy. The UK's future relationship with the EU will not be clear for some time.

The European Commission has said that freedom of movement of goods, services and capital is conditional on the UK accepting freedom of movement of people – something that the referendum showed many of the British electorate were reluctant to accept. The government may either have to make concessions on migration to retain access to the European single market, or it might have to accept a less beneficial free trade agreement or customs union. Community law currently affects national taxation in several ways and the implications for business tax will depend on the outcome of the negotiations between the UK and the rest of the EU.

In the days after the vote, former Chancellor George Osborne, looking to mitigate the potential risks of leaving the EU, trailed a cut in corporation tax to 15% or less. The new Chancellor, Philip Hammond has not committed himself to this but wants to focus on measures to boost business investment and securing the ability of the financial services industry to do business in the EU.

VAT and customs

The UK hasn't formally left the EU yet and will only do so sometime after Article 50 is triggered. Once the UK has left the EU, constraints on some tax changes may be removed. Speculation that the UK might abolish VAT is almost certainly unfounded. VAT generated £115 billion last year, which would be difficult to replace, and the continuation of VAT is likely to be a prerequisite for UK access to the European single market.

It is possible that in future, UK VAT might diverge from EU VAT law, for example by extending the zero rate, but there may be advantages to maintaining alignment to avoid double taxation or non-taxation. The UK will probably need to change some of the rules about the treatment of supplies made between UK and EU member states.

UK businesses are likely to lose access to the developing one-stop shop arrangements, which will remove the need for cross-border businesses to register in up to 28 jurisdictions. So UK companies that currently sell directly to consumers in other member states may be adversely affected and may have to set up warehouses within the EU to continue to benefit from the current rules.

Customs procedures and duties may be imposed on businesses trading with the EU if the UK leaves the EU customs union without entering into a free trade agreement.

Other taxes

Leaving the EU should remove the prohibition on state aid to business, making it easier for the government to provide tax incentives such as enhanced capital allowances and relief for research and development. The extent of withholding taxes on interest could change. And if the UK leaves the EU social contributions system, Britons working in the EU may find themselves paying contributions in both the UK and where they are working.

Although direct taxes are under national control, the government does have to ensure that corporation tax rules are consistent with EU law, the principle of fiscal neutrality and freedom of establishment and of movement of capital, people and services. For example, EU law has affected the UK's group relief system and the controlled foreign company rules. Outside the EU, a government might wish to favour UK companies fiscally. On the other hand, EU governments might discriminate against UK businesses.

Much could remain the same if the UK joins the European Economic Area. In any case, structural change to UK tax is likely to be slow. We will keep you informed so that you can make best use of the opportunities that may arise and mitigate any difficulties.

Failure to prevent bribery

A recent case underlines how the failure to prevent bribery under the Bribery Act 2010 is an offence for which a firm can be severely fined, even if it acts in an exemplary way afterwards in reporting the offence to the authorities.

Braid Logistics discovered potentially dishonest activities in connection with two contracts. The company dismissed those involved and voluntarily reported the case to the Crown Office. Despite these actions, Braid Logistics ended up paying £2.2 million in settlement. What led to the payment was section 7 of the Bribery Act, which makes the failure to prevent bribery an offence. There is a full defence, but only if it can be shown that appropriate procedures designed to prevent bribery are in place.

The size of the settlement is a stark warning of the importance of having appropriate anti-bribery procedures. The scope of section 7 is very broad, embracing the whole range of persons connected to a company who might be capable of committing bribery on the company's behalf. This could include contractors and suppliers.

What counts as appropriate procedures will depend on the bribery risks faced by a business, and also its size and complexity. Few procedures will probably be needed for a small business facing minimal bribery risks. So research the markets you operate in and the people that you deal with, especially if entering into a new business arrangement. Don't forget that we are here to help so please get in touch if you need advice.

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.

October

5 Deadline to register for self-assessment for 2015/16.

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

22 Pay tax and Class 1B NIC on PSAs (19th if not paying electronically).

31 Deadline for 2015/16 tax return if filed on paper.

November

2 Submit employer forms P46 (car) for quarter to 5 October 2016.

December

30 Deadline to submit 2015/16 tax return online to have underpaid PAYE tax of up to £3,000 collected through the 2017/18 tax code.

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