Spring 2015

Talking Tax

Guiding you to lifelong prosperity

Welcome

As we breathe a huge sigh of relief that the January rush is over and tax returns for another year are filed, we find ourselves facing the end of one tax year and a new one beginning.

In this issue we have, therefore, focused on some of the key changes in the world of tax from April 2015 (including some that have already been introduced following the Autumn Statement) and look at the key announcements from the recent Budget. We also go back to basics looking at when inheritance tax will be triggered and some simple ways it could be reduced. And just as we have got to grips with all of that, more changes could be just ahead depending on the result of the election next month. In the words of Rod Stewart, albeit maybe in a somewhat different context, "never a dull moment"!

Contents:

HAZLEWOODS

DRIVING LIFELONG PROSPERITY

Access to **R&D tax credits** for smaller companies - voluntary advance assurances, time to process claims to be reduced and new guidance to be published.

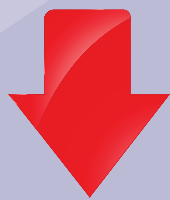
Increased flexibility for **ISAs** allowing withdrawal and replacement of money in a cash ISA during the same year without using up part of the individual's annual limit.

A new **'Help to Buy ISA'** will allow first time buyers to save for a UK property. The government will contribute £50 to every £200 saved by the individual up to a maximum contribution of £3,000.

Class 2 NIC to be abolished in the next Parliament and Class 4 NIC to be reformed. Detail yet to be announced but it is expected that Class 4 rates will be increased to compensate.

Budget deficit is down by more than a half compared to 5 years ago (10.2% in 2009/10 to 5% in 2014/15)

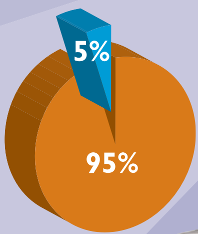
Corporation Tax rates aligned to 20% for all company profits as previously announced



Farmers averaging of profits for income tax extended from two to five years.

The **UK economy** had the fastest growth in 2014 from the G7 economies

Entrepreneurs' Relief tightened once again restricting when an asset used in a business qualifies, and also to ensure a minimum 5% shareholding in a trading company.



Pension pot lifetime allowance to reduce from £1.25million to £1million from April 2016. Transitional rules to protect those with a pot of over £1million prior to that date.

A new **'Personal Savings Allowance'** was announced for April 2016. Tax will not be payable on the first £1,000 of savings income for basic rate taxpayers and the first £500 for higher rate taxpayers.

95% of savers should no longer pay tax on their interest following this change.

Tax returns are to be abolished and replaced with digital tax accounts.

The digital accounts will be populated by HMRC using information they already hold. Rather than submitting a tax return taxpayers will instead go to their online account, review and confirm that the information is correct.

It is anticipated that by 2020 the majority of individuals and small businesses will no longer be filing tax returns, but how complex the new system will be remains to be seen.

Tax free **personal allowance** to be increased from £10,600 in 2015/16 to £10,800 in 2016/17 and £11,000 in 2017/18.

Plus commitment to increase the personal allowance to £12,500 further down the line if re-elected.

Stamp of approval

The Chancellor's rabbit out of the hat in the Autumn Statement was a radical reform of Stamp Duty Land Tax (SDLT) with the aim of boosting the housing market. From 4 December the calculation of SDLT on purchases of residential property changed to a progressive tax, much like the income tax system. There were no changes to the charge for commercial or mixed-use property.

The old system was a 'cliff edge' approach such that once the house price tipped over into the next band the new rate applied to the whole price. For example, a house sold for £500,000 would have had a SDLT rate of 3% costing £15,000 but if it exchanged hands for £500,001 the 4% rate would have applied costing the purchaser £20,000 i.e. an extra £5,000 of tax for a £1 increase in price!

With the same example, under the new system, there will be no tax payable on the first £125,000, 2% on the next £125,000 and 5% on the remaining £250,000 i.e. total SDLT of £15,000 whether the purchase price is £500,000 or £500,001. This is a big improvement and a very welcome announcement for most. It should certainly help with houses valued just over the old bands of £250,000 and £500,000.

The new progressive rates are:

0 - £125k	0%
£125k - £250k	2%
£250k - £925k	5%
£925k - £1.5m	10%
Above £1.5m	12%

The majority of people purchasing a residential property should benefit from the new system, up to a price tag of £937,000, which the Chancellor estimated should cover 98% of property purchases. Those buying houses at a higher price than this will pay an increased amount of SDLT. The tax on a £2.1m property would have been £147,000 under the old system, whereas £165,750 of SDLT will now be payable.

> "Overall, however, it is a tax giveaway. It is forecast to save house-buyers about £800m of SDLT per year. This should be a boost for the residential property market and will be a big help for first-time buyers."

An end to **HMRC's goodwill** on incorporation

A less welcome announcement from the Autumn Statement brought about an immediate change to the taxation of goodwill for business incorporations.

In the 'good old' days

Over the years, many sole trader and partnership businesses have chosen to incorporate and run their business through a company. Such decisions were largely driven by commercial and legal reasons but tax, as always, also played a big part.

One of the main tax benefits of an unincorporated business selling its trade and assets, (including goodwill), to a company owned by the same individuals was that the sale proceeds could be left outstanding as a loan, which could later be repaid out of the profits generated by the company post incorporation.

Providing certain criteria were met, Entrepreneurs' Relief could be claimed on the disposal, resulting in tax at a rate of 10%. The company would then be subject to corporation tax at a rate of 20% on profits, the balance of which could then be used to repay the loan account with no additional personal tax liability.

This was a very tax efficient way to extract cash from the company, which would otherwise be subject to income tax if it were drawn as salary or dividends (with national insurance also possibly applicable to salary payments). This route provided ongoing tax benefits when compared to income tax of up to 45% plus national insurance for the individual, that would be payable had the business remained unincorporated.

In addition to the above, new businesses, broadly those established after 1 April 2002, could claim tax relief for the amortisation (depreciation) of any goodwill transferred to the new company, therefore reducing the company's corporation tax bill.

It's all history

In an unexpected move, the Chancellor changed the landscape for business incorporations in respect of the taxation of goodwill, effective from 3 December 2014.

Firstly, goodwill acquired by a close company (broadly one controlled by five or fewer people) related to the seller no longer qualifies for Entrepreneurs' Relief. This change increases the tax payable by a business on a future incorporation from the Entrepreneurs' Relief rate of 10% to the main rate of 28% (or possibly 18% to a limited degree).

With the tax rate on the sale increased to 28%, this makes the sale of goodwill in exchange for the loan account a less attractive proposition, particularly as the tax is payable up front and there are usually no actual sale proceeds from which to pay it. Whether a sale of the goodwill in this way is still a viable option will depend on whether the larger liability can be funded and if that liability will be outweighed by the annual savings in the longer term. Furthermore, there may be a more efficient method of extracting profits from the company, depending on each individual's personal circumstances.

Secondly, corporation tax relief on the amortisation of goodwill was withdrawn where the company acquires the goodwill from a related party, regardless of when the business commenced trading, resulting in the same tax treatment now for all related party goodwill disposals.

Is this the end?

There is no question that these two measures have reduced the tax benefits associated with goodwill, unless there is a sale to an unconnected third party and change of ownership.

> "However, this is by no means an end to incorporation."

There are other reliefs available such that the tax liability on incorporation could be avoided, but these will generally not result in the creation of a loan account. However, with corporation tax rates reducing over the past few years (and down to 20% for all companies from April 2015) and with no income tax or national insurance due on dividends paid out up to the basic rate band (currently £41,865) the on-going savings may still make incorporation worthwhile, depending on the specific circumstances of the business and individuals involved.

In addition, other chargeable assets transferred into the business as part of the incorporation, such as property, are still eligible for the 10% tax rate. Stamp Duty Land Tax (SDLT) may also be mitigated by partnerships on incorporation, if the property is transferred in to the new company and not retained personally. Transfers of property by a sole trader would prove less attractive as SDLT would likely apply.

In conclusion, tax on incorporations can still be minimised if structured correctly and may continue to offer on-going benefits to the owners. Businesses still operating as a sole trader or partnership should, therefore, not write off incorporation as a future option to run the business, just yet.

New year, **new rules**

As a new tax year begins, we highlight below some of the key changes coming into force from April 2015.

Corporation tax rates

Corporation tax rates are finally aligned with a 20% tax rate for all companies big and small to meet the Chancellor's aim of creating one of the most competitive tax regimes in the G20.

Companies that are currently within the quarterly instalment payments (QIPs) regime for corporation tax, by virtue of having associated companies, could now be taken out of QIPs following a change to the definition of "associated company".

Broadly, from 1 April 2015 companies will now only be treated as associated if one company is controlled by the other or if they are both under the common control of another company. Control through an individual, partnership or LLP will be ignored for these purposes. So, for example, if Mr Hazlewood owned five individual companies, they would not be associated under the new rules. However, if one of those five companies owned the others, in a group structure, they would be associated.

There may be planning opportunities, depending on the circumstances, to ensure that companies do not fall into the QIPs regime.

Zero-rated CO2 emissions company cars

Eco friendly has historically equalled tax friendly, with 100% capital allowances afforded to companies purchasing ***zero-rated CO2 emissions company cars*** for their employees and no income tax charge on the benefit received by the individual. However, from April 2015 the tax free benefit-in-kind is no more and employees with zero emission vehicles will now be subject to tax at 5% of the list price. This upward trend is set to continue with the rates also increasing across all other cars for 2015/16 and then by a further 2% in the following year.

The choice of company car can have a huge impact on the tax charge paid by the individual and zero/low emission cars, although not tax free, will continue to be more tax efficient. Set out below is an example of what £30,000 might buy you in the current market and the difference it could make to your tax bill depending on whether it is an eco car or a gas guzzler.

The below example is based on a higher rate taxpayer, but your bill will be halved if you only pay tax at the basic rate.

		2014/15		2015/16		2016/17	
	CO2 emissions	Benefit in kind	Tax	Benefit in kind	Tax	Benefit in kind	Tax
Mercedes Benz B Class Electric	0	0	0	£1,500	£600	£2,100	£840
BMW 3 Series 320i M Sport	147	£6,600	£2,640	£7,200	£2,880	£7,800	£3,120
Chrysler Grand Voyager 2.8	207	£10,200	£4,080	£10,800	£4,320	£11,100	£4,440

Personal allowance

The ***personal allowance*** is to increase by £600 to £10,600. From 6 April 2015 it is also possible to transfer up to £1,060 of personal allowance between married couples/civil partners. In practice this will be mainly applicable to single earner households, where the non-working spouse's personal allowance would have otherwise been wasted. This relief will not be available where the receiving spouse is a higher or additional rate payer (i.e. they must be paying tax at the basic rate to benefit).

Tax of up to £212, i.e. £1,060 x 20% basic rate, could be saved through the transfer and although not the same as winning the lottery is nevertheless a simple way to save some tax.

Starting rate for savings income

The ***starting rate for savings income*** reduced from 10% to 0% and the savings starting rate tax band will increase from £2,880 to £5,000. In reality this change will only be likely to apply to a small minority, such as pensioners and low income savers.

With a personal allowance of £10,600 plus the £5,000 savings band, this means that an individual will not be subject to tax on savings until their total taxable income (excluding dividends and capital gains) exceeds £15,600. For example, an individual receiving a salary of, say, £8,000 plus interest income of £7,600 would not be subject to any tax as it would be covered by the personal allowance plus the nil rate savings band. However, if their salary was to increase to, say, £12,000 then £4,000 of the interest would become taxable at 20%.

In the first scenario, as all of the interest income would be tax free it would be possible to register for gross interest payments with your bank, however, under the second scenario it would be necessary to claim the excess tax deducted at source back from HMRC.

There may be remuneration planning opportunities following the introduction of the nil rate savings band depending on the individual's circumstances.

Class 2 national insurance (NI) contributions

Changes to the collection of ***class 2 national insurance (NI) contributions*** will come into force from April. Rather than a monthly or quarterly direct debit, or bi-annual bill, collection will be under self assessment and class 2 NI will become due on 31 January of the year following assessment e.g. 31 January 2017 for the 2015/16 tax year.

The last payments under the old collection process will be due on 10 July 2015 and, in the meantime, no new direct debit applications are being accepted by HMRC. HMRC will automatically cancel any direct debits following the last payment in July 2015, but it's always worth checking!

If you pay class 2 NI you should have already received a letter from HMRC explaining this and a separate payment request for the period to 11 April 2015 will be sent out during April 2015 for those who do not pay by direct debit.

VAT on prompt payment discounts

Changes to the rules on declaration and recovery of ***VAT on prompt payment discounts*** also come into effect. Previously, suppliers could account for VAT on the discounted price even if, subsequently, the full amount was paid by the customer. From 1 April 2015 the VAT accounted for and paid must be based on the monies actually received by the supplier.

These rules are already in effect from 1 May 2014 for supplies of broadcasting and telecommunications services. The table below summarises the before and after position for all other supplies.

Going forward the supplier must detail the full price on their VAT invoice to the customer and the VAT based on that price. It should also show the discount rate offered for prompt payment and associated terms (e.g. timescale to receive the discount), as well as a statement that the customer can only recover the input VAT actually paid. If the invoice doesn't include these details then the supplier would need to issue a credit note for the discount element if subsequently taken up by the customer.

Customer		Supplier	
Pre 1 April 2014	Post 1 April 2015	Pre 1 April 2014	Post 1 April 2015
Recovery of input VAT as stated on the invoice (regardless of whether full amount paid or not)	Recovery of input VAT based on the amount actually paid	Account for VAT on the discounted price (even if full price later received)	VAT accounted for on the amount actually received
Example based on a £10,000 (exc VAT) invoice with a 10% discount offered for prompt payment			
VAT recovery of £1,800 regardless of whether £10,000 or £9,000 actually paid for goods/service	VAT recovery of £2,000 if £10,000 paid and £1,800 if prompt payment discount applied	VAT accounted for at £1,800	VAT initially accounted for as £2,000 and reduced by £200 if prompt payment discount is taken up

Pensions v ISAs

With the recent shake up to pensions and some changes to ISAs there has been a lot of talk as to where your long term savings are best accumulated. The answer is... it depends.

Where ISAs are NISA

The ISA investment limit is currently £15,000 and is set to rise to £15,240 from April 2015. From July last year the ISA was also reformed into the NISA removing the previous restriction of only being able to invest up to half in cash. It is now possible to invest in any combination of cash or stocks and shares.

ISAs do not offer tax relief on the initial investment but subsequent income generated is tax free. This is in contrast to pensions which offer tax relief on the way in but are taxed on the way out. If you are likely to want to make sizeable withdrawals on retirement then ISAs may be the way to go.

> “Unlike a pension, ISAs can be accessed at any time so if there is a chance you will need to dig into your savings before turning 55 the ISA will win the battle.”

In the 2014 Autumn Statement, the Chancellor announced that ISAs can now be passed on free of tax on death to the surviving spouse. The funds can be transferred into their ISA with an additional allowance for that year equal to the value of the deceased's ISA.

Previously if the surviving spouse had already used their full limit or if the funds were higher than the annual limit the tax benefits would be lost. However, with death tax changes also introduced on pensions as detailed below, ISAs are up against firm competition.

Where pensions win out

Higher and additional rate tax payers are likely to be the main winners for pensions. Currently tax relief at 40% or 45% will be received when paying into a pension. On retirement you could receive 25% as a tax free lump sum and, providing you only receive a pension up to the basic rate band, will pay 20% tax on the remainder.

At the present time, it is generally only possible to pass a pension on as a tax free lump sum if you die before the age of 75 and you have not taken any tax free cash or income. Otherwise, any lump sum paid from the fund is subject to a 55% tax charge. From April 2015 this will change, and this automatic tax charge will be abolished. The tax treatment of any pension you pass on will depend on your age when you die, but will be completely tax free if it is before you reach 75.

Pensions are victorious over ISAs here as it is passed on tax free to any beneficiary, not just the spouse. However, if you are in good health and likely to live past 75 any drawdown will be taxed at the marginal rate of the recipient which could tip the scales back slightly in the favour of ISAs.

> “Pensions will also offer a lot more flexibility for draw-down from April 2015 and can be accessed from the age of 55, as wished, or left for the next generation.”

Removing previous restrictions of drawdown has received positive reactions from most and the flexibility afforded leaves them not too far behind ISAs in terms of accessibility.

Pensions also win on inheritance tax as they generally fall outside of the estate whereas ISAs do not. If the ISA is passed on to the spouse on death a tie may be called as it will be exempt from inheritance tax. However, on the second spouse's death it will form part of their estate and inheritance tax may become due.

Overall winner

The best approach will depend on personal circumstances but the imminent changes on pensions are likely to place them in poll position to provide the best tax advantages for most.

Inheritance Tax
- back to basics

The Chancellor has hinted that inheritance tax (IHT) cuts are ahead, as he plans to ensure it is only paid by the 'rich'. What this means in real terms is yet to be seen but with the upcoming election it is expected that the Conservatives will use this as one of their manifesto pledges. In the meantime we go back to basics and look at when IHT will apply and some simple ways an individual can reduce their IHT bill, in a quick-fire Q&A round.

Q. What is IHT and who is affected?

A. IHT is a tax paid on assets left behind on death and on some settlements on trusts or gifts made during lifetime. Individuals who are UK domiciled or deemed domiciled are chargeable to IHT on their world-wide assets. Non-domiciled individuals are only charged to IHT on their UK assets.

Q. What are the rates of IHT?

A. Based on current rates, the first £325,000 of value transferred during a person's lifetime or on death is taxed at 0%. This is a tax free allowance known as the 'nil rate band' (NRB). Chargeable lifetime transfers (e.g. gifts into trusts) above £325,000 within any seven year period are taxed at 20%. The excess above £325,000 passing on death, or gifted within seven years before death, is generally taxed at 40%.

Q. Can the NRB be transferred?

A. Since October 2007 it is possible for spouses and civil partners to transfer the NRB unused on the first death to the surviving spouse for use on their death. This allows the possibility of doubling the NRB available on the second death. In some circumstances, more than two NRBs can be claimed.

Q. When is IHT payable on lifetime gifts to individuals?

A. During a person's lifetime most gifts are not subject to an immediate charge to IHT but may become due if the donor dies within seven years of making the gift. The IHT charge is based on the value of the gift at the date the gift was made and is taxed at the rates applicable at the date of the donor's death. Tapering relief may reduce the IHT liability if the donor survives for more than three years but less than seven years from the date of the gift.

Q. Can an asset be gifted but continued to be used whilst still alive?

A. The gifts with reservation of benefit rules prevent an individual making a lifetime transfer of an asset, but continuing to have the use and enjoyment of that asset. If they still use the asset without paying a market rent, the asset will either form part of their estate for IHT or they will be subject to an income tax charge under separate rules.

Q. Are any lifetime gifts exempt from IHT?

A. The following lifetime gifts are exempt from IHT:

- Gifts between UK domiciled spouses or civil partners with no limit.
- Gifts to UK registered charities with no limit.
- Every person has an annual exemption per tax year of £3,000. (This can be rolled forward for one year if unused, but the current year's allowance must be used first).
- Small gifts of up to £250 to any number of people.
- Gifts for family maintenance including the transfer of a property on divorce or the maintenance of dependant relatives.
- Gifts made as normal expenditure out of income.
- Wedding gifts (depending on the relationship with the couple):
  - By parents, of up to £5,000
  - By remoter ancestor, of up to £2,500
  - By anyone, of up to £1,000

Q. Who pays the IHT?

A. Any IHT that becomes due on a lifetime gift, because the donor dies within seven years, is paid by the donee unless the gift is specified as being free of IHT. On death it depends on how the property is held - personally, jointly or via a trust. In most estates, the executor or personal representative is responsible for paying the IHT.

Q. When must IHT be paid?

A. In most cases the IHT bill must be paid within six months of the end of the month in which the death occurred. After this, interest will be charged on the amount outstanding.

It is possible to pay in annual instalments over ten years if the value of the estate is tied up in property, such as a house or unquoted shares.

Q. Are any tax reliefs available for IHT?

A. There are two main reliefs:

1. Business Property Relief (BPR)
2. Agricultural Property Relief (APR)

These reliefs effectively remove the value of many business interests and farms from the charge to IHT, subject to detailed conditions being met.

Q. How can an individual reduce their IHT bill?

A. Up front planning is essential to help minimise an IHT bill as far as possible, with a few ideas set out below:

- Up to date Will in place that has been drafted tax efficiently.
- Ensure that exemptions and reliefs mentioned above are fully utilised.
- Consider legacies to charity to reduce the IHT rate from 40% to 36%.
- Use the NRB in full by making chargeable lifetime transfers of up to £325,000 and lifetime gifts of more than this, as these will fall out of account after seven years.
- Consider the use of trusts.
- If assets qualify for 100% BPR or APR, consider passing to children or a trust in order to 'bank' the relief.

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