Talking Tax

GUIDING YOU TO LIFELONG PROSPERITY

Winter 2015

BIG PROPOSALS

Welcome...

Before the festive celebrations get into full swing and the wind down to the Christmas break begins, we thought we would send you an early present – the Winter 2015 Talking Tax! We have started celebrations early here, following our recent success at the British Accountancy Awards, winning 'Top 50 Tax Team of the Year'.

In this issue we look at the complexities with applying for the new marriage allowance and a quick cheat to get around this. We also delve into the detail of some of the big proposals from the Summer Budget and summarise the key announcements from the Autumn Statement. In the meantime, we hope you have a fun filled Christmas break and we wish you a very happy and prosperous New Year.

INSIDE

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AUTUMN STATEMENT – NOT VERY TAXING

After a very 'exciting' Summer Budget which was packed full of shock tax announcements, the Autumn Statement seemed tame in comparison. There were very few tax revelations of note, with the focus of the speech being on spending and cuts.

Some of the key tax announcements included:

- Proposed Tax Credit changes scrapped
- 0.5% apprenticeship levy for employers where payroll costs are greater than £3million
- New 60% penalty for successful challenges under GAAR, although this legislation has yet to be invoked to date
- 3% stamp duty land tax 'surcharge' on buy-to-let and second homes
- Capital Gains Tax on residential properties will be payable 30 days after the transaction from 2019 (currently 31 January following the end of the tax year the gain was made)
- Councils to be given the power to set differing business rates
- Income cap of £100k for the new Tax Free Childcare regime to be introduced in 2017
- 3% diesel supplement on company cars will now stay in place until 2020 (was set to be removed from 2016)
- Sixth form colleges to be given opportunity to become academies and save VAT
- £800m to be invested to tackle tax evasion

There was a lack of detail to support the announcements but it is expected that further clarification will come when the Finance Bill is published on 9 December. The Finance Bill is also expected to include the hotly anticipated draft legislation for the dividends tax reform which was announced in the Summer Budget. This should help to provide further clarity for remuneration planning from April 2016.

Hazlewoods tax team win prestigious national award

We are very proud to announce that our Hazlewoods Tax Team, won 'Top 50 Tax Team of the Year' at the 2015 British Accountancy Awards in November.

The award was open to tax teams within firms that had been placed in the 2014 Accountancy Age Top 50 Survey. We were up against tough competition in our category including one 'Big 4' firm and three others in the Top 10.

The award recognised tax advice that has delivered greatest measurable benefit to clients, demonstrating the high value of quality professional tax advice during the past 12 months.

Nick Haines, Head of Tax said *"I am so incredibly proud of the tax team and all the hard work they put in, day in, day out, which has resulted in this award. We have a great team, with a wide breadth of experience and expertise that has helped our clients to be as tax efficient as possible and also keep them protected from an increasingly challenging HMRC. To win in such tough competition is a fantastic achievement, but one that has been thoroughly deserved by the team".*

TO BTL OR NOT TO BTL, THAT IS THE QUESTION

The Summer Budget 2015 announced changes to restrict relief for buy-to-let (BTL) landlords of residential property. There have been calls of 'bah humbug' from landlords, as the Chancellor launched a two pronged attack which could result in significant tax increases on rental businesses. These proposals have instigated much negative press, along with an unsuccessful petition to the government by landlords.

Whether these changes will lead to landlords selling up, or increasing rents to cover the additional tax costs, will remain to be seen. Initial indications, however, suggest the market will remain buoyant as low fixed rate mortgages continue to be offered keeping borrowing costs down.

MORTGAGE INTEREST RELIEF RESTRICTION

The first measure was to restrict relief for mortgage interest costs on residential properties to the basic rate of tax.

This restriction is not set to come in until April 2017 and will be phased in over four years. From 2017/18 higher/additional rate relief will only be available on 75% of a landlord's mortgage interest, with the remaining 25% attracting basic rate tax relief only. This proportion will increase by 25% each year until 2020/21 when 100% of a landlord's mortgage interest will only get basic rate tax relief.

WHO WILL BE AFFECTED?

Any buy-to-let landlords with mortgages on their residential rental properties could be affected by the change. Even though the headlines were around higher rate and additional rate taxpayers being restricted to basic rate tax relief, basic rate taxpayers could be pushed into the 40% tax bracket as a result of these changes. This is because rather than a straight deduction of interest from rental profits, the new rules provide instead for a tax credit.

Below are a couple of examples of the potential additional tax payable for a higher rate and basic rate taxpayer. For the purpose of these examples we have assumed a personal allowance of £11,000 in both years and a basic rate band of £32,000. For simplicity, it has also been assumed that the only expense against the rental business is the mortgage interest.

EXAMPLE 1

Emma, a higher rate taxpayer, owns a buy-to-let property worth £350,000, with an interest rate of 4% (i.e. interest cost of £14,000 per annum) and gross rental income of £18,000.

		CURRENT RULES		2020/21	
Salary		£65,000		£65,000	
Rental profit		£4,000		£18,000	
Taxable income		£69,000		£83,000	
	Tax rate	Tax band	Tax	Tax band	Tax
	0%	£11,000	£0	£11,000	£0
	20%	£32,000	£6,400	£32,000	£6,400
	40%	£26,000	£10,400	£40,000	£16,000
Less tax relief on interest	20%			£14,000	(2,800)
Total tax liability			£16,800		£19,600
Rental tax liability			£1,600		£4,400

In 2021 Emma would have additional tax of £2,800 to pay as a result of the new rules. Emma's effective tax rate on her rental profits will be 110% (i.e. £4,400 tax versus £4,000 profit).

EXAMPLE 2

Karen owns a buy-to-let property with the same income and expenses as Emma but is a basic rate taxpayer and believes that she will not be caught by the new rules.

		CURRENT RULES		2020/21	
Salary		£39,000		£39,000	
Rental profit		£4,000		£18,000	
Taxable income		£43,000		£57,000	
	Tax rate	Tax band	Tax	Tax band	Tax
	0%	£11,000	£0	£11,000	£0
	20%	£32,000	£6,400	£32,000	£6,400
	40%			£14,000	£5,600
Less tax relief on interest	20%			£14,000	(2,800)
Total tax liability			£6,400		£9,200
Rental tax liability			£800		£3,600

In 2021 (assuming that the bandings are still the same) Karen would have additional tax of £2,800 to pay. In this example, Karen will have an effective tax rate of 90% against her rental profits (i.e. £3,600 tax against a £4,000 profit).

The above examples show how the effective tax rate can be significant and quite unexpected.

FURNISHED PROPERTIES – WEAR AND TEAR ALLOWANCE

The second measure is to abolish the wear and tear allowance from April 2016. Rather than a straight 10% deduction against gross rents for furnished properties, landlords will instead be required to deduct the actual cost of replacing furnishings in the relevant tax year.

This change could lead to fluctuating tax bills for the taxpayer and may result in an overall increase in tax for many landlords as they are unlikely to replace furniture each year. If, however, you are planning to incur significant costs on replacing furniture in the near future, you may wish to defer this until after April 2016 to maximise your relief.

The only landlords who are likely to be unaffected by the new rules are those that own furnished holiday lets. They can continue to claim capital allowances for furnishings and any loans relating to furnished holiday lets will continue to receive full relief for mortgage interest costs.

WHERE WE CAN HELP

We can help you to calculate the additional tax that will be payable and explore options in relation to the best holding for your property investments. There may be opportunities to mitigate the effects of these measures through the use of property companies, trusts or simply bringing spouses into the property business.

Deemed UK domicile – the proposals

Another surprise announcement in the Summer Budget 2015 was for non-domiciled (non-dom) individuals. From April 2017, individuals who are not UK domiciled but have spent 15 out of the last 20 years in the UK will be treated as deemed domiciled for all UK tax purposes.

WHAT IS A NON-DOM?

A non-dom is an individual who is resident in the UK, but domiciled in another country under general law. Non-doms enjoy several tax advantages over UK domiciled individuals, including relief from inheritance tax for assets situated outside the UK, and access to the "remittance basis" meaning that UK income tax and capital gains tax is only due on foreign income or gains if wealth is brought into the country.

In recent years the tax net has tightened on non-doms, generally by imposing a time limit on how long these advantages may be enjoyed, or by paying an annual charge to continue to benefit from the remittance basis.

CURRENT RULES

Currently non-doms are deemed to be UK domiciled and subject to inheritance tax on their worldwide estate once they have been resident in the UK for 17 out of the last 20 years.

A charge to use the remittance basis for other income and gains will apply unless the individual has been resident in the UK for less than seven of the last nine tax years. The current remittance charges are £30,000 for individual's resident for at least seven of the last nine tax years and £60,000 for individual's resident for 12 of the last 14 tax years. From April 2015 a new remittance charge of £90,000 was also introduced for non-doms who have been resident in the UK for 17 out of the last 20 years.

NEW RULES

As mentioned, any non-doms resident in the UK for 15 of the last 20 tax years will be treated as deemed domiciled in the UK from April 2017. All worldwide assets will be subject to inheritance tax in the UK two years earlier than under current rules and it will no longer be possible to claim the remittance basis for any foreign income and gains. The new £90,000 remittance charge will become redundant as anyone falling within this category will be automatically deemed domiciled.

In addition, individuals who were both born in the UK and acquired a UK domicile at birth but later left the UK and acquired a non-UK domicile of choice could be affected immediately at the point of return to the UK. Under the proposals as soon as they become UK resident again they will automatically be treated as UK domiciled.

Although not detailed in the announcement itself, the consultation suggests that the clock could be restarted for the new 15 year domicile rule if the individual becomes non-resident for six complete tax years. Whether this will lead to a number of non-doms heading off to sunnier climes for a six year holiday or not remains to be seen.

The proposals are not yet set in stone so things could still change, but it is clear that the government is looking to tighten the rules for non-doms. Some planning might be possible before the new rules bed in but should be considered plenty of time in advance, and preferably before April 2016. If you would like any advice please get in touch with your usual Hazlewoods contact.

Dividends taxation reform

The Conservative government have committed to no rises in income tax, national insurance or VAT rises during the current parliament, as promised in their election manifesto. This was welcome news as it provides some certainty for the next five years, or so we thought...

What they failed to mention during the election process was that they would be carrying out a complete overhaul of the taxation of dividends and introducing new rates of tax.

Amongst those most likely to be affected will be owner managed businesses who, typically, take a small salary and large dividends to make up their remuneration package. Also, individuals with a portfolio of listed shares paying out dividends are also likely to see a rise in their tax bill from next year.

OUT WITH THE OLD...

Under the current regime, the effective rate of tax for dividends is 0% for basic rate taxpayers, 25% for higher rate taxpayers and 30.56% for additional tax rate payers. This takes into account a notional 10% dividend tax credit applied against the headline rates of 10%, 32.5% and 37.5% respectively. Under this regime, it is currently possible to receive gross dividends of up to £42,385 (based on 2014/15 allowances and assuming no other taxable income) before being subject to income tax.

AND IN WITH THE NEW

From April 2016, the dividend tax credit will be abolished and all individuals will be able to receive £5,000 of dividend income tax free under the new Dividend Allowance. As each person will be entitled to the allowance, regardless of whether they are basic, higher or additional rate taxpayers, owner managed businesses should look to utilise both spouse's £5,000 allowance if possible. HMRC have recently confirmed that this allowance will be taken into account when calculating taxable income and that it will still count towards the basic/higher rate bands.

The tax rates on dividends in excess of this amount will be 7.5% for basic rate tax payers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. Dividends will continue to be tax free in ISAs and pensions.

SALARY OR DIVIDENDS

Dividends should still be more tax efficient than paying a large salary although there will be an increased tax cost to the individual from next year.

For example, a director previously receiving a small salary of, say, £8,000 and dividends up to the basic rate band would not have been subject to income tax or national insurance. However, from April 2016, tax of approximately £2,000 would be due if that director was to continue to receive the same level of net cash.

SOLE TRADE OR INCORPORATION

With recent changes to the taxation of goodwill, the tax benefits associated with incorporating a business have reduced somewhat. When also factoring in the impact of the new dividends regime, many people are asking whether this could be the final nail in the coffin for incorporation.

After running some initial calculations, and based on our understanding of the new rules, we can conclude that incorporation should not be discounted by businesses, however, the potential tax benefits are going to be less.

Incorporating a business should continue to be a viable way to save or defer tax, especially when profits are retained in the business to fund growth or to pay down any bank debt. Reducing corporation tax rates to 18% by 2020 may also tip the balance in favour of a company structure. Of course, other non-tax commercial factors should also be considered.

Do I need to take any action now?

As the new regime will only affect dividends paid after 5 April 2016, and with detailed rules yet to be released, there may be no reason to immediately alter your remuneration for the 2015/16 tax year. After the Christmas break, however, and certainly before April 2016, you might want to give some consideration to the following:

- acceleration of dividend payments into the current tax year;
- a full review of your remuneration strategy for the 2016/17 tax year to determine whether your tax liability could be reduced by altering your existing approach;
- a review of your business operating structure.

If you would like any advice on how these changes could affect you and/or assistance with a review of your remuneration strategy or operating structure please do let us know.

UNIFORM ALLOWANCES FOR EMPLOYEES

Do you or your employees wear a uniform to work? As a general rule, employees cannot get tax relief for the cost of clothing worn to work. However, there are certain exceptions to this depending on the sector you work in.

HMRC have approved a list of flat rate deductions for certain employees who have to wear a uniform or specialist clothing for work. The flat rate deduction is intended for those who have to pay for the cost of replacing, repairing and cleaning the specialist clothing. Please note that you cannot claim for the initial cost of buying this clothing. Also, a deduction would not be available if your employer reimburses you for such expenses.

A list of entitled occupations and the amounts which can be claimed can be found within HMRC manuals at EIM32712. A few examples of claimants are as follows:

OCCUPATION	£
Heating engineers	120
Joiners / Carpenters	140
Nurses, midwives, chiropodists, dental nurses, occupational, speech, physiotherapists and other therapists, healthcare assistants	100
Agricultural Workers	100
Motor Mechanics	120
Workers in the food industry	60

If your occupation is not listed and you have to wear a uniform, you may still be able to claim tax relief on £60 per annum. Much to our surprise, Santa and elf impersonators are not included on HMRC's list but the £60 relief should apply providing you have purchased the outfit at your own expense.

If you incur more than this, it might be possible to claim, but a deduction for more will not be permitted by HMRC without adequate evidence of the expenditure incurred. If you are unsure whether the above applies to yourself or your employees please do not hesitate to contact us.

A CHEAT'S GUIDE TO CLAIMING THE MARRIAGE ALLOWANCE

HMRC introduced a tax break for married couples on 6 April 2015. A Marriage Allowance of up to 10% of a spouse's or civil partner's unused personal allowance can be transferred providing:

- their partner's income is between £10,601 and £42,385; and
- both partners were born on or after 6 April 1935.

The objective of the measure is to encourage marriage, however, with an average wedding costing £20,000 and a tax saving of just over £200 per year (£212 for 2015/16) it may not spur you on to take the plunge and propose this Christmas. For those already married though, the saving may prove a welcome contribution towards the Christmas present fund.

WHO WILL BENEFIT?

In practice this will be mainly applicable to single earner households, where the non-working spouse's personal allowance would have otherwise been wasted. It could also benefit pensioners, where one spouse receives a pension up to the basic rate band with the other spouse having no (or low) taxable income.

HOW TO CLAIM

HMRC recommend that you make the claim for Marriage Allowance via their website at: www.gov.uk/marriage-allowance. However, this has proven to be a time consuming process and does not always have the desired effect.

The usual route for making other elections is via letter to HMRC, stating the particular parts of the legislation you are making a claim under. We have experienced success claiming the Marriage Allowance using this age old method of writing a letter, despite HMRC's claim that it should be done online. If you wish to try this route, the individual with the excess personal allowance should write to HMRC and state that "As defined under s.55B(2) ITA 2007 I wish to make a transfer of the transferable amount to my spouse for the 2015/16 and subsequent tax years."

You should also include the following details:

- Full names, dates of birth and national insurance numbers of transferor and transferee.
- Date of your marriage / civil partnership.
- Confirmation that you meet the eligibility criteria as set out in s.55B(4) ITA 2007.

If required, we can provide you with a proforma letter for making this claim, but as yet, Agents are unable to make this election on client's behalf.

Once your election has been processed, both spouses should receive revised PAYE coding notices which show the additional allowances transferred to the higher earning spouse. Please ensure that any PAYE Coding Notices are checked carefully for accuracy, or passed to your advisor at Hazlewoods.

Tax issues on divorce

Taxation issues are usually the least of a couple's worries when they are starting the process of separation. However, once the dust has settled and the sometimes lengthy process of asset division has begun, taxation implications can come to the fore.

Where an asset has appreciated in value and is subsequently disposed of, capital gains tax (CGT) is usually payable. Transfer of property between spouses benefit from a "no gain, no loss" basis for CGT. However, this **CGT exemption only applies in the tax year of separation** and not after, irrespective of whether the divorce has been finalised. Between separation and divorce, they are treated as connected persons and any transfers of assets between them must be at deemed market value. It is therefore imperative to attend to the issue of asset division and taxation as soon as is practically possible.

The most common areas which affect our clients relate to the following:

FAMILY HOME

Where the family home is your only/main residence throughout your period of ownership, you will be entitled to full principal private residence relief (PPR), from any CGT. PPR is limited though, and once one spouse moves out of the property they have 18 months before their share of the property could be exposed to some CGT.

Separate from CGT, there is an exemption to Stamp Duty Land Tax (SDLT) on transfers of any property directly connected to the divorce; there is no time limit on this exemption.

FAMILY BUSINESS

Spouses commonly hold interests in family businesses, particularly with all the husband and wife tax planning which has taken place over the last few years. The tax exemption between spouses will apply in the year of separation. Restructuring of the business or the company might be required to minimise the tax leakage and it may be necessary to take advantage of other tax reliefs, such as gift relief or Entrepreneurs' Relief depending upon the circumstances.

INVESTMENT PROPERTY

The Courts often want to know the options available in respect of the potential division of jointly held investment properties. Therefore the inherent capital gains often have to be calculated. Tax reliefs might be available in some circumstances such as an exemption for the exchange of joint interests in property.

CHATTELS

Chattels are tangible, moveable items of property (furniture, paintings, household goods, jewellery, vehicles etc.). Private cars are exempt from CGT and so would not present a problem on transfer. Other chattels only need to be considered from a tax perspective if they are valued at more than £6,000 and on which there is a gain.

TAX CREDITS

The divorcing couple may not have had to consider tax credits before, or they may already be reliant on them. If they are new to tax credits, they should apply as soon as possible as a claim can only be backdated by 3 months. If an individual is already claiming, they must notify HMRC within 3 months following the change in their personal circumstances.

INHERITANCE TAX (IHT)

Unlike for CGT, for IHT purposes, it is the date of the decree absolute that triggers the change in tax treatment. It is also worth emphasising that wills should also be considered when separation takes place, as a divorce will invalidate an existing will.

Separation and divorce can be an extremely stressful time in a person's life. Sadly, particularly with acrimonious situations, we see a lot of asset division cases taken to court to determine the settlements. As with a lot of court cases, this process can be lengthy and the opportunity for tax savings (i.e. in the year of separation) has often passed. We are still able to help mitigate tax issues in these instances, and by advising on the tax implications of potential settlements, we can help to ensure an appropriate outcome, without any nasty tax surprises.

VAT

THE VAT MAN: CAPRICIOUS OR CALCULATING?

Businesses are responsible for applying the appropriate VAT liability to their sales, but they must also determine the correct amount of VAT that they are entitled to recover on their costs/expenses. Erroneous input tax claims will result in the imposition of penalties by HMRC. Businesses should therefore be aware that there have been some recent developments regarding VAT claims which are both adverse and favourable.

PRE-REGISTRATION VAT ON GOODS

When a previously unregistered business registers for VAT, accepted practice has been that all of the VAT can be reclaimed for goods purchased up to four years before registering, providing the items were used in the business and are still held at the date of registration. Whilst denying that there has been a policy revision, HMRC now appear to have changed their interpretation of the rules. In their Guidance Manuals they state that a claim for pre-registration input VAT should be reduced to take into account the use that has been made of the goods before registration.

VAT ON TRANSACTION FEES/DEAL COSTS INCURRED BY ACTIVE HOLDING COMPANIES

HMRC have previously argued that transaction fees are consumed in the acquisition process and have no connection with future taxable supplies, hence the VAT is not recoverable. However, a recent European Court of Justice (ECJ) ruling determined that holding companies that actively manage subsidiaries can fully deduct the VAT paid on the costs of acquiring subsidiaries even if there is no direct link between the costs and the VAT taxable supplies they provide to the subsidiary, such as administrative, financial, commercial and technical services. The ECJ ruled that the VAT incurred by an active holding company in making acquisitions will be deductible as the costs form part of the holding company's general costs (overheads).

DIY HOUSEBUILDER'S SCHEME

Recovering the correct amount of VAT does not just apply to businesses. There have been three cases recently where HMRC have tried to apply penalties for incorrect claims under the DIY housebuilder's VAT refund scheme, and failed! Most DIY claimants are dealing with VAT for the first time and cannot be expected to get things 100% right. Where a claim has been made and turned down, to then issue a penalty was an inappropriate reaction by HMRC, according to the Tribunal, and in each case, the penalties were dismissed. However HMRC's attitude is clear, and DIY scheme claimants must remember they can only claim the VAT that should have been applied, not what their supplier may incorrectly have charged.

The above cases highlight the ever-changing nature of taxation and how HMRC sometimes appear to lack a common sense approach. If you are thinking of registering for VAT, making a VAT claim for a DIY build, or are even unsure about your compliance requirements please do not hesitate to get in touch with our VAT team at Hazlewoods.

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