Talking Tax

DRIVING LIFELONG PROSPERITY

Spring 2017

SPOTLIGHT ON THE FINAL SPRING BUDGET

Welcome...

to the Spring 2017 Talking Tax. In this issue we have something for everyone! This includes an update on the latest Making Tax Digital proposals, as well as highlights from Philip Hammond's first and last Spring Budget!

For employers, we highlight how the new trivial benefit in kind rules allow for more treats and gifts than ever for their employees.

For companies, we consider some options for exit planning and reorganisation strategies as well as tax efficient remuneration for owner managed businesses.

Lastly, we look at some planning opportunities for individuals following the raft of new rules targeted at landlords to increase their tax bills. This includes the new interest relief restriction rules on buy-to-lets and the SDLT charge on additional property purchases.

INSIDE

HAZLEWOODS
DRIVING LIFELONG PROSPERITY

SPRING BUDGET 2017

INCOME TAX

The tax free dividend allowance of £5,000 introduced in April 2016 will be cut to £2,000 from April 2018. This will largely impact director-shareholders of owner managed businesses and lead to a tax bill increase of up to £975 for higher rate taxpayers.

NATIONAL INSURANCE (NI)

In addition to the dividend allowance cut, Class 4 NI will be increased from April 2018 to narrow the tax gap between the employed and self-employed. The main rate will increase by 1% to 10% in 2018 and to 11% in 2019 but no increase was announced to the 2% rate above the basic rate band.

PERSONAL TAX THRESHOLDS

It was confirmed that the personal allowance for 2017/18 will be increased to £11,500 and the higher rate threshold to £45,000. By the end of parliament, the thresholds will rise to £12,500 and £50,000 respectively.

CORPORATION TAX

Also confirmed were the corporation tax rate reductions to 19% from April 2017 and 17% from 2020.

CAPITAL GAINS TAX (CGT)

The CGT annual exemption is to be increased to £11,300 from April 2017 (currently £11,100).

MAKING TAX DIGITAL

Small unincorporated businesses below the VAT threshold (£85,000 for 2017/18) will not be subject to the new digital quarterly reporting rules until 2019, deferred by one year despite calls to exempt them completely.

LIFETIME ISA

From 6 April this year, the Lifetime ISA will be available for younger adults who can save up to £4,000 per annum and receive a government bonus of up to £1,000. The savings can be used to purchase a first home or retained until they turn 60.

SDLT

The payment window for SDLT had been set to reduce from 30 days after the tax point (completion or substantial performance) to 14 days with effect from April 2017. This has now been deferred until April 2018.

VAT

The registration threshold will increase to £85,000 from 1 April 2017 (£83,000 for 2016/17) and the deregistration threshold will be £83,000 (£81,000 for 2016/17).

SAVINGS

As previously announced, the ISA allowance will increase from £15,240 to £20,000 from April 2017.

Making Tax Digital – to go ahead

Following on from the Making Tax Digital (MTD) consultations at the end of last year, the government has now released its response and confirmed that it will forge ahead as planned. This is despite widespread concerns from professional bodies, advisers and clients across the country on many aspects of the proposals and timeframe to implement.

In short, from April 2018 unincorporated businesses and landlords with turnover above £85,000 will be required to make regular, quarterly, digital communications to HMRC.

Hazlewoods responded to the main consultation document and, although a few of the concerns our tax team raised have been addressed, there are still many uncertainties and issues to iron out.

FILING DEADLINES

The filing deadline for the 'End of Year activity', which will essentially replace the current self-assessment tax return, has now been confirmed as the earlier of 31 January or 10 months from the end of the period of account.

We expressed our concern on the original proposed nine-month filing deadline, given that this would lead to a 31 December deadline for all those with a 31 March or fiscal year end. As agents we weren't particularly keen on telling our staff that their busiest period would be brought forward to Christmas nor disturbing our clients' festive breaks with queries and requests. Thankfully HMRC took heed of this!

The filing deadline for the quarterly reports is to be one month after the quarter end, as previously announced.

Bizarrely, the information submitted in the quarterly reports does not have to be accurate, nor does HMRC have the power to enquire into them, which leads us to wonder of their true benefit. Our view is that this is likely to be a precursor to real time information reporting and payments, as is currently the case for payroll.

SMALLER BUSINESSES

HMRC has listened, in part, to concerns over the additional burden for the smallest businesses. We raised a concern over the original proposals that spreadsheets would not be accepted by HMRC under the MTD rules, given that many of our clients keep their records in this format.

Following this, HMRC has confirmed that businesses will be able to continue to use spreadsheets for record keeping but that they must be capable of meeting the requirements for MTD. To achieve this, it is likely that spreadsheets will need to be used in conjunction with some basic software. We can assure you that we will have the necessary software to link from your spreadsheets to HMRC's digital accounts.

We also suggested raising the turnover threshold for those needing to comply with MTD from £10,000 to at least the VAT registration threshold, which is £85,000 for 2017/18. Following many similar comments, the government had confirmed that it would give further consideration to the exemption threshold. However, unsurprisingly, in the Budget announcement it appears the threshold will remain, but with a one year deferral for those below the VAT threshold.

PARTNERSHIPS AND CHARITIES

Larger partnerships with turnover of over £10million will not have to comply with MTD until 2020 (i.e. the same time the rules will be introduced for companies).

Charities will not be subject to MTD and will not be required to keep digital records, but any trading subsidiaries of charities will be within the new rules. We expressed some concerns about this given that the profits of most trading subsidiaries will be gift aided to the charity and hence will generally not have a tax bill, but this has not been heeded.

TIMING AND PENALTIES

As mentioned, the government has confirmed that MTD will go ahead under the timescales originally announced for most. Reporting requirements will commence for unincorporated businesses with accounting periods beginning on or after 6 April 2018.

A pilot scheme will run from April 2017 and we have signed up to be a party to it, so that we can assess the process and provide our clients with the peace of mind that we will be able to make the transition as pain free as possible.

To soften the blow slightly and help with the transition, no penalties will be levied for late submission of quarterly or end of year reports in the first 12 months.

NEXT STEPS

Draft legislation has been published, but there are still some gaps and missing answers as highlighted above. We remain concerned that the government is rushing into what is arguably the biggest change since the introduction of self-assessment. With just 12 months to go, however, we will be contacting our clients separately over the coming months to discuss the transition and the support we can offer.

Not so trivial

It is common for employers to want to provide their employees with gifts or perks during the year. Less welcome, however, is when we tell them that the gift is subject to tax on the employee.

From April 2016, legislation was introduced to provide more certainty in this area, with a prescribed exemption for trivial benefits. Previously there was no statutory provision, however, HMRC did have guidance allowing certain trivial benefits, without specifying an actual value. A benefit will now only be treated as 'trivial' if it meets all of the following conditions:

- the cost of providing the benefit must not exceed £50;
- the benefit cannot be cash or a cash voucher (but high street vouchers are fine);
- the employee should not be entitled to the benefit contractually (including salary sacrifice); and
- the benefit must not be in recognition of services performed by the employee as part of their employment.

If all of the above conditions are satisfied, the benefit will not count towards an employee's taxable income and does not need to be reported on a P11D.

If the benefit exceeds £50, the whole amount is taxed, not just the excess.

INTERACTION WITH OTHER EXEMPTIONS

The guidance states that where there is more than one potential exemption, the outcome most favourable to the employee should be applied. Any staff entertaining events below £50 per head could therefore be treated under the trivial benefits exemption and any larger events may qualify under the £150 annual parties and functions exemption.

This flexibility potentially gives employers the opportunity to provide its employee with more perks and benefits than ever before without triggering a tax charge on the employee.

ANNUAL CAP FOR DIRECTORS

Directors of close companies (broadly a company with five or fewer shareholders or where all of the shareholders are also directors) can receive benefits totalling a maximum of £300 in any given year. This can be made up of multiple benefits providing each is below £50.

For example, if the director has received £270 of trivial benefits during the year and then receives a £50 high street voucher, this benefit would not be exempt. However, if before the year end they then received a £30 bottle of wine, this could be treated as trivial and take their benefit up to £300. If gifts are made to family members of the director (who are not employees or directors of the company) then any trivial gifts provided would count towards the directors £300 limit.

Rather generously, there is no similar cap for other employees and they can receive any number of trivial benefits during the year.

Landlords beware!

From 6 April 2017, there are new rules to restrict tax relief on mortgage interest costs for residential property landlords. Tax relief for interest (and any other finance costs relating to the property) will be restricted to the basic rate of tax.

The rules work so that the rental profits are taxed before any finance costs. A deduction of 20% of the finance costs is then subsequently applied. This calculation method of the tax due means that it is not only higher rate taxpayers that will be affected by the new rules, but basic rate taxpayers could also be tipped into the higher rate tax band. For some worked examples see our article in our Winter 2015 Talking Tax (https://hazlewoods.co.uk/Tax-Winter2015).The calculations are further complicated because the rules are being phased in over four years so that only 25% of finance costs will be restricted to the basic rate in 2017 and then increasing by 25% each year, until fully implemented by 2020.

We have calculated effective tax rates of over 100% on rental profits for some clients, making it unsustainable in certain cases to continue with their current operating structure. There are ways, however, that the impacts of the rules can be mitigated, a few of which have been set out below.

SPOUSAL TRANSFERS

If a spouse pays tax at a lower rate, or does not work at all, it may be more tax efficient to transfer part or all of the property(ies) to them. With the personal allowance at £11,500 from April 2017 and the basic rate band extended to £33,500, taxable income (before finance costs) would need to be kept below £45,000 to avoid being taxed at the higher rate.

TRIVIAL OR NOT?

Some of the more common benefits have been set out below and circumstances where they may or may not qualify as a trivial benefit.

TOO GOOD TO BE TRUE?

The new rules do appear to be extremely generous and offer employers the opportunity to provide their employees with perks, without the negative tax implications. We would not be surprised if HMRC tighten the rules in the future or impose further annual limits, so you may want to seize the opportunity to treat your employees now.

TRIVIAL BENEFITS	NOT A TRIVIAL BENEFIT
High street voucher worth £50 or less for a non-work related event e.g. Christmas, new baby, marriage etc.	Gift voucher of any value provided to employees for meeting certain performance targets or 'sales person of the month' etc.
Meal provided by the employer to celebrate birthdays or other events (e.g. summer party) where the average cost per head is less than £50.	Gift provided at Christmas where it is possible to determine the cost per individual e.g. bottles of wine provided to the directors at a cost of £60 each but to other employees at £15 per head, only the latter would be exempt.
Turkey/wine/chocolate provided at Christmas provided the cost does not exceed £50 per individual (or less than £50 average cost per head if it is not practically reasonable to split).	Taxi provided from work to home after working late (but may qualify under the late night taxi exemption).
	Christmas party at a cost of greater than £50 per head (but may qualify under the annual parties and functions exemption).

PARTNERSHIPS

Partnerships are subject to the new rules in the same way as individuals. However, spreading the rental income amongst more than one person by establishing a partnership (e.g. with family members) could also be considered.

INCORPORATION

The new rules only apply to individuals running a residential property business and not companies. One possible option, therefore, could be to look at incorporating the property business.

Tax charges such as capital gains tax and stamp duty land tax could be triggered on the transfer of the property(ies) into a company, however, there are ways in which these can be minimised and in some cases reduced to nil, depending on the specific circumstances of the existing business.

Modelling would also need to be undertaken to determine the tax savings that could be achieved under a company structure, minus the additional costs to run a company.

If you have any questions on how the new rules work, would like to understand what impact it will have on your tax bill and/or what you can do to try and minimise the impact, please do get in touch with Nick Haines or your usual tax contact.

SDLT SURCHARGE ON ADDITIONAL PROPERTIES

New rules were introduced 12 months ago to levy a 3% surcharge on the existing SDLT rates for additional residential property purchases (such as buy-to-let or holiday homes).

As with the mortgage interest relief restrictions highlighted in the previous article, the government's intention is to slow down the buy-to-let market and use the additional taxes raised to fund home ownership schemes. The latest statistics published by the government show that property purchases in general have reduced compared to the previous 12 months (other than a spike in March 2016 immediately prior to the new rules being introduced).

The rules broadly apply where, following the transaction, an individual purchaser owns two or more properties and has not replaced their main residence. For full details of the rules and applicable rates see our article in Spring 2016 Talking Tax (http://hazlewoods.co.uk/Tax-Spring2016).

The additional SDLT charge can be significant and in the past year we have come across a number of instances where the charge unexpectedly applies and results in a much higher bill than anticipated.

CASE STUDY

Facts

Mr X and Miss Y each own a property separately. Mr X lives in the property owned by Miss Y and has done so for a considerable amount of time, but has never been added to the title deeds or mortgage. Mr X and Miss Y would like to jointly purchase a new property to live in and Miss Y will sell the property they are currently living in at the same time.

SDLT position

As it stands, on acquiring the new property Mr X would own two properties. He would not be replacing his main residence as he does not have any rights or interest in Miss Y's property. As a result, on acquiring the new property the SDLT 3% surcharge would apply to the full consideration.

How we can help

It is possible to carry out some planning in advance of the property purchase such that Mr X has an interest in Miss Y's property, therefore, when purchasing the new property both he and Miss Y will be replacing their main residence. This SDLT saving could be significant depending on the value of the property, but as an indication on a £300,000 house, SDLT savings of £9,000 could be achieved.

If you are looking to purchase a new property and you, or anyone you are purchasing the property with, already own a residential property (whether it is in the UK or abroad) the SDLT surcharge could apply. In certain cases there may be the opportunity to plan around the surcharge, but with complex rules the first step is to determine whether it will apply and factor that in to your purchase budget, if appropriate.

TAX EFFICIENT COMPANY RECONSTRUCTIONS

We have recently carried out a number of company reorganisations and demergers for clients looking to split their business activities into separate entities.

There are a number of reasons as to why the owners may want to divide the business assets but some of the more common ones include:

- to protect one or more of the business activities;
- to separate the properties from the trading activity;
- to split different trading activities in advance of a sale of one of the businesses, or to prevent customer confusion; or
- to divide the business assets between the shareholders if they wish to go off in different directions.

The process to split out the different business activities could result in significant tax liabilities both for the existing company and the shareholders, including capital gains tax, income tax and stamp duty land tax. However, with careful planning the tax liabilities can often be minimised or mitigated altogether.

When carrying out a demerger or company reconstruction it might also be possible to structure such that it is more beneficial from an inheritance tax perspective.

SOLVENT LIQUIDATION

Most commonly a solvent liquidation (under section 110 Insolvency Act 1986) is carried out. This normally involves a number of new companies being established to split the business activities, one of which is subsequently liquidated. As the assets are distributed to the shareholders on wind-up of the company there is no income tax or capital gains tax charge on the shareholders.

CAPITAL REDUCTION DEMERGER

An alternative to a solvent liquidation is a capital reduction (under The Companies Act 2006). This route has become much more attractive following a relaxation in the rules in 2008 for private companies wishing to reduce their share capital. Court approval is no longer required for a capital reduction, only a shareholders' special resolution supported by a director's solvency statement.

The demerger is effected by splitting out part of the company's assets into a new company, which is owned by some or all of the existing shareholders. The share capital in the existing company is reduced and consideration for the cancelled shares is given to the shareholders by issuing shares in a new company which holds the demerged assets.

SDLT and liquidation costs can be saved under the capital reduction route and it is arguably simpler than the liquidation route as only part of the business' assets needs to be transferred out. Similarly, a capital reduction demerger results in no income tax distribution or capital gains tax liability for the shareholders.

TAX EFFICIENT REMUNERATION FOR THE OWNER MANAGED BUSINESS

With the new tax year about to commence, an annual review of your remuneration is always recommended to ensure your tax bill is minimised as far as possible. For the owner managed business, there are a number of different ways that you can be remunerated.

For the 2017-18 tax year it is possible to receive as much as £22,500 from the company tax free and double that if your spouse is also involved with the business.

HOW TO REMUNERATE

The right remuneration will depend on the specific facts and circumstances of the company and the individual, including:

- whether the company has sufficient distributable reserves to pay a dividend;
- what other income the individual receives from sources other than the company; and
- if the company has a loan outstanding with the individual.

However, in general the most tax efficient remuneration is achieved by a combination of a low salary, high interest and high dividends.

Salary

The salary taken should be high enough so that your national insurance history is protected but generally no higher than the personal allowance which is £11,500 for 2017-18. Any salary taken above this would be taxed at 20%, 40% or 45% depending on the amount received (see enclosed tax facts booklet for further details).

Interest

If the company owes the director money, interest can be charged on the loan. There are two savings allowances available which can result in no tax due on the interest received.

The first is the 'starting savings rate' which allows up to £5,000 of interest received to be tax free. This is, however, reduced by £1 for every £1 of non-savings income above the personal allowance of £11,500 in 2017-18. Once non-savings income exceeds £16,500 the starting rate for savings would not be available.

The second is the 'personal savings allowance' which exempts the first £1,000 of interest for basic rate tax payers, £500 for higher rate tax payers, but is not available for additional rate taxpayers.

Dividends

The first £5,000 of dividends (£2,000 from April 2018) paid to an individual is exempt from tax, regardless of any other income received. After this, tax is paid at 7.5%, 32.5% or 38.1% for basic rate, higher rate and additional rate taxpayers respectively.

Although the dividend tax rates have increased recently, they are still lower than income tax rates. Note, though, that the corporation tax position should also be considered (see below).

CORPORATION TAX

For corporation tax purposes, any salary or interest paid would be a tax deductible cost for the company and tax relief would be obtained at 19% on the gross amount.

Conversely, however, any dividends paid out would not be tax deductible and corporation tax would not be saved.

EMPLOYEES RUNNING THE SHOW

Everyone is familiar with the John Lewis operating structure where its employees are also shareholders of the company and participating in the company's profits. Until recently, however, there has been little interest in following suit.

From 2014, new rules were introduced to make similar structures more tax efficient and, as a result, they have become much more popular in recent years.

HOW IT WORKS

Indirect ownership of the company by the employees is typically the most common way to structure. This is achieved by establishing an Employee Ownership Trust (EOT) to hold the majority (i.e. greater than 50%) of the shares in the company for the long term benefit of the company's employees. Effectively, the employees then indirectly own the business in which they are employed.

The company typically makes contributions to the EOT which are then used to purchase the owner's shares. As mentioned above, at least 50% of the shares must be held by the EOT, but this can be as high as 100% if the owner wants a complete exit, which can be carried out gradually over a period of time.

All employees must benefit from the EOT, so it is not possible to just offer shares in the EOT to the more senior members of the business, as with many other employee share schemes.

WHAT ARE THE ADVANTAGES?

COMMERCIAL	TAX
Provides a succession/exit route for the owner where they do not wish to sell the company nor have a family member willing or wishing to take over the business	Original shareholders of the company can dispose of their shares to the EOT exempt from capital gains tax (compared to a 10% rate assuming entrepreneurs' relief applies).
Increased productivity and engagement of employees.	The consideration is often left outstanding and future earnings can be released without income tax or NIC charges.
Could help to increase profitability of the company.	There are no tax liabilities for the employees by holding the shares on trust (providing they are not earmarked for specific employees).
	Bonus payments of up to £3,600 per year made to all qualifying employees on the same terms are exempt from income tax (but not NIC).

Although the tax position makes such a structure more attractive, the decision to implement should ultimately be commercially driven.

WOULD IT BE SUITABLE FOR YOUR BUSINESS?

If you are looking to return some or all of your investment, then an EOT could be a neat, relatively straightforward and tax efficient way to achieve an exit from the business. As highlighted above, this could be particularly attractive where there is no clear succession plan in place.

If you would like to realise some cash, but still want to be involved in the business, this can also be achieved using an EOT. Although more than 50% of the shares will need to be sold, the existing owner can become a trustee of the EOT and so will retain effective control of the business, until such time as he/she is happy to pass over the reins.

MEET THE TAX PARTNERS

NICK HAINES
01242 237661
nick.haines@hazlewoods.co.uk

TOM WOODCOCK
01242 237661
tom.woodcock@hazlewoods.co.uk

RUTH DOOLEY
01242 680000
ruth.dooley@hazlewoods.co.uk

DAVID CLIFT
01242 680000
david.clift@hazlewoods.co.uk

NICHOLAS SMAIL
01242 680000
nicholas.smail@hazlewoods.co.uk

Windsor House, Bayshill Road, Cheltenham, GL50 3AT
Tel. 01242 237661 Fax. 01242 584263

www.hazlewoods.co.uk / @Hazlewoods_Tax

HAZLEWOODS
DRIVING LIFELONG PROSPERITY