# Legal Focus

**DRIVING LIFELONG PROSPERITY**

February 2022

# SPOTLIGHT ON TAX

## *Welcome...*

Welcome to the winter edition of our Legal Focus. In this edition, we look at LLP members status review, overseas employment taxation and, as we approach the end of the tax year, we take a look at year-end tax planning tips.



## INSIDE


→ LLP members – another year, another status review
→ Spotlight on... Hannah Griffin
→ Basis period reform – where are we now?
→ Year-end tax planning checklist
→ Employment taxation – the overseas element?
→ A look ahead to 2022/23


HAZLEWOODS

DRIVING LIFELONG PROSPERITY

# LLP members – another year, another status review

**Once again, it is time to review each member's status to ensure they can continue to be taxed as a self-employed individual.**

As always, each of the conditions must be looked at separately, and just one needs to be failed for a person to be self-employed:

## CONDITION A – VARIABLE PROFIT SHARE

This test is measured over the period in which the member's profit-sharing arrangement is in place. This could of course be the start of the tax year, but will generally be the date on which any pay review takes place.

In order to fail this condition, an individual has to demonstrate that 20% or more of their earnings are linked to the profitability of the firm as a whole, as opposed to their own position or department.

The LLP agreement should clearly set out what element of the member's profit share is fixed and what element is variable.

YES

NO

## CONDITION B – SIGNIFICANT INFLUENCE

The test must be applied whenever a new member joins and whenever there is a change to a member's rights and responsibilities within the LLP.

In order to fail this condition, the LLP agreement must clearly set out the member's rights and responsibilities and demonstrate that the member is able to exert significant influence over the LLP's affairs as a whole.

Equally important for this condition are internal records, which should support a member's role as a key member of the LLP.

YES

NO

## CONDITION C – CAPITAL CONTRIBUTION

In our experience, this is by far the most popular condition that firms rely on.

In order to fail this condition, the amount of capital required is still at least 25% of total anticipated remuneration, including bonuses, in the year - and, again, it needs to be reviewed if circumstances change.

There is a two month grace period for newly appointed members.

YES

NO

EMPLOYED

SELF-EMPLOYED

# Spotlight on... Hannah Griffin

A Q&A with Hannah Griffin, Associate Partner at Hazlewoods.

## WHAT IS KEEPING YOU BUSY AT WORK?

Work for a forensic accountant can be incredibly varied and no two days are ever the same. However, there are some trends at the moment, such as divorce cases that keep coming – COVID-19 and Christmas has put added pressure on relationships, so we are busy with business valuations, liquidity assessments and considering the most tax efficient ways to fund settlements.

It is not just personal relationships that have been under strain though. We are seeing more and more shareholder disputes and parties seeking to dispose of minority share interests, both in formal court proceedings and outside of the court system. Then there are the breach of warranty claims and transaction disputes, which are hot at the moment, as well as business interruption work.

In a nutshell, lots going on to support litigation matters or to help parties resolve matters before reaching that stage.

## WHAT CHALLENGES DO YOU FACE IN YOUR CURRENT WORK?

The COVID-19 pandemic has turned the world upside down. Who would have thought that their used car could now be worth more than they paid for it?

Disruption to supply chains, enforced closures and furlough schemes means the role of the forensic accountant has become more complex. Valuing businesses often requires the valuer to assess the future maintainable profits of a business, yet the last two years have been anything other than normal! Many disputes require an assessment of the counterfactual scenario 'How would the contract have performed but for the breach now in dispute?'

I absolutely love these new challenges and working with our team to consider and test the evidence to support our assessment. One of Hazlewoods biggest strengths is the people and their sector expertise, which has been invaluable in many of the cases we are currently dealing with.

## WHAT SHOULD CLIENTS BE THINKING ABOUT AT THE MOMENT?

I think the message for clients is to engage early with experts. A forensic accountant can be a key member of a team involved in strategy, assessing the merits and vulnerabilities of a claim and advising on the preservation of evidence. However, things do not need to have reached the formal dispute stage to benefit from this support, and early engagement could prevent escalation. The preservation of evidence is key, and a forensic accountant can advise on the evidence that should be captured – evidence obtained at the time of the event is more likely to be considered credible than evidence recreated when there is a dispute in process.

## TELL US SOMETHING THAT WE MIGHT NOT KNOW ABOUT YOU?

Although I am not particularly interested in motorsport now, my father designed lights for cars and I found rally driving quite exciting. I was lucky enough to sit as co-driver for the Swedish rally drivers Per Eklund and Stig Blomqvist during a visit to the UK. An experience I will never forget!

If you would like to know more, please get in touch with Hannah at hannah.griffin@hazlewoods.co.uk or 01242 680000.

# Basis period reform – where are we now?

In July 2021, the Government issued a consultation and draft legislation for a proposed change in the way profits are taxed for those sole practitioners, partnerships and LLPs that do not prepare their accounts to 31 March or 5 April. This is part of a bigger project moving towards Making Tax Digital for income tax.

HMRC has proposed that all self-employed individuals and partners will in future be taxed on a tax year basis, rather than an accounting year basis, i.e. individuals will pay tax on profits arising in each tax year, regardless of the firm's accounting date.

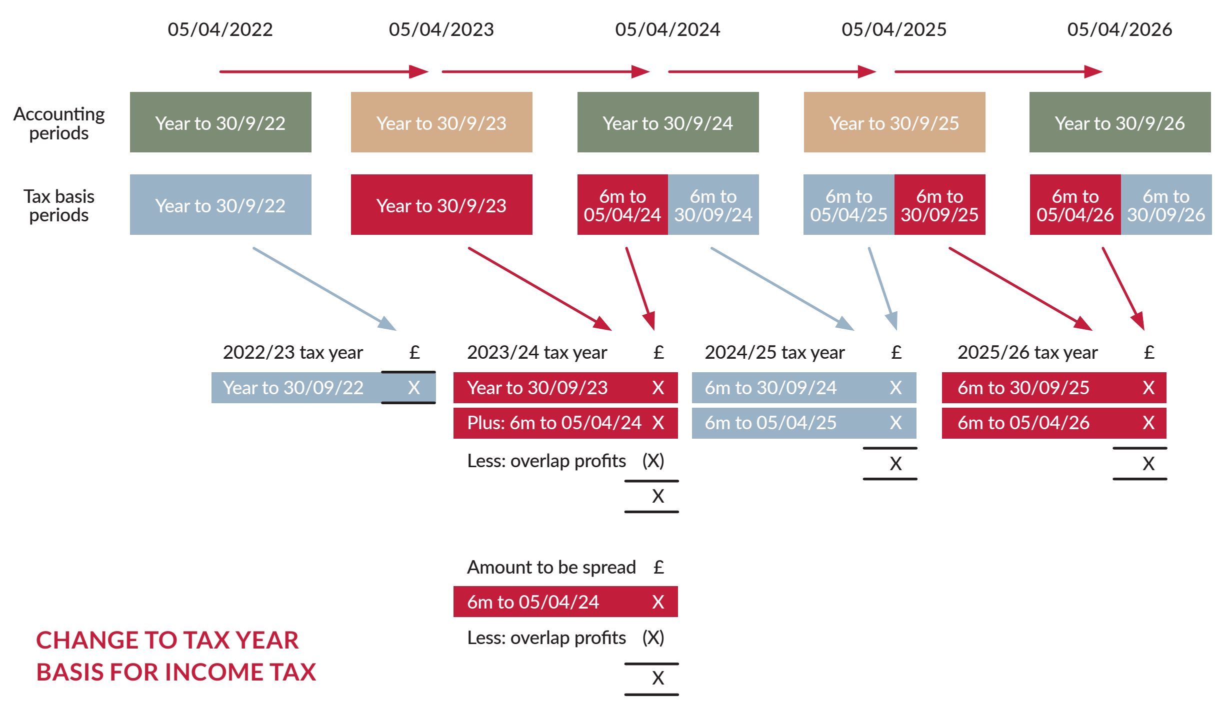
The consultation originally recommended implementation of these changes from April 2023, with a transitional period in the 2022/23 tax year.

## ANNOUNCEMENTS IN OCTOBER BUDGET

Since the consultation, there have been some welcome amendments to the original draft legislation:

1. The change will now take place from April 2024, with a transitional period in 2023/24 – a whole year later than originally planned, which gives everyone more time to prepare.
2. An adjustment to the way that income is calculated for the purposes of restricting personal allowances, pension annual allowances and higher income tax benefit charge, so that the transitional period will not impact on these specific allowances.
3. The updated legislation also appears to allow for a change of accounting date to 31 March or 5 April 2024 in the transitional year and still allow spreading of transitional profits up to that date over five years. In the draft legislation this was not possible.
4. The Government has recognised that there will be administration issues for firms with an accounting date close to the end of the tax retun filing date (e.g. December year-ends), as those firms will have just one month to finalise their accounts and apportion profits accordingly before they are included on tax returns. Whilst not yet finalised, options that are being currently explored to address this issue include:
   - 4.1 Reporting provisional figures on the tax return, which can be amended at the same time as filing the following year's tax return.
   - 4.2 Extending the filing deadline for certain taxpayers e.g. the more complex partnerships, etc.
   - 4.3 Amending any differences between provisional and actual figures within the following year's tax return.
   - 4.4 Retaining the current rules, so that estimated figures can be amended once the actual figures are known.

Pulling this all together, and by way of an example, the table below summarises the impact of changes over the next five years on a firm with a 30 September accounting date.




**CHANGE TO TAX YEAR BASIS FOR INCOME TAX**

## ACTION REQUIRED NOW

Whilst the 12 month delay in the introduction of these new rules will be welcomed, all it is doing is delaying the inevitable, and firms need to start focusing on what needs to be done now, so they are ready to deal with the change. This includes:

1. For most firms, the changes will not involve paying more tax – rather it is an acceleration of tax payments, and therefore it is a cashflow management challenge. Managing lock-up is key to allowing sufficient cash to be generated over the period of the transition.

   Good lock-up management starts from the moment you take on a client, and reminding all staff of the need to communicate with clients, bill regularly, etc. is all going to help.

2. The decision of whether to spread the transitional profits over five years lies with the partner, not the firm. A partner may, for personal reasons, prefer to accelerate the transitional profits, but if the firm usually pays the tax then there could be a potential conflict between what works for one party but not the other. Preparing projections of what the transitional period could look like for the firm and individuals, even at this stage, with various scenarios, is important, as it should allow for all of those issues to come to the surface.

3. For owners that are looking to retire between now and 2027/28, timing of retirement is key, and the impact of the spreading needs to be considered as part of the plan, particularly in terms of timing of pension contributions, etc. Taking advice early on and, where possible, being open with fellow partners about retirement plans, will help smooth over the cashflow impact for all parties.

4. Although 2023/24 seems a long way off, it will come around very quickly. Scenario planning needs to be looked at in terms of growth, timing of investments, etc, over the next three to four years, whilst dealing with the transitional period, which will allow a firm to look at ways of managing the overall cashflow impact.

# Year-end tax planning checklist

**As we approach the end of another tax year, now is a good time to consider whether all allowances and reliefs have been maximised as far as possible, and whether any action needs to be taken before 5 April 2022.**

To make it easier to identify the points that might affect you, we have broken them down by category of who they affect.

| WHO IS AFFECTED? | DESCRIPTION | ACTION TO TAKE? |
|---|---|---|
| HIGHER EARNERS | The personal allowance is reduced by £1 for every £2 of net income over £100,000. As a result, the marginal rate of tax for income of between £100,000 and £125,140 could be as high as 60%. | If your income is close to these thresholds, consider ways to reduce your taxable income, such as making pension contributions, charitable donations, deferring income into 2022/23 or transferring income-generating assets to your spouse. |
| HIGHER EARNERS | Any donations to charity will reduce your tax liability by extending your basic rate band. For example, if you donate £800, this is grossed up to £1,000 on your tax return, and your basic rate band is extended by this amount. If you are a higher rate taxpayer, this will reduce your tax payable by at least £200. | Consider making additional charity donations before 5 April 2022. Also, dig out any gift aid certificates, so that they can be included on your tax return.<br><br>If you are a partner in a partnership or LLP, ensure that any donations are made in your own name, not through the partnership, to ensure tax relief is available. |
| HIGHER EARNERS | The annual allowance for pension contributions is £40,000 for 2021/22, although this is reduced proportionately for individuals with taxable income above £240,000, until it reaches a maximum contribution level of £4,000 at a total taxable income level of £312,000 (or more).<br><br>Anyone who is a higher rate or additional rate taxpayer will receive tax relief at their highest marginal tax rate on any contributions into pension schemes. | Consider making additional pension contributions to utilise your allowance for 2021/22. It is also possible to make use of unused pension contribution allowances for the previous three tax years.<br><br>Specific pensions advice needs to be taken before making any decisions. |
| SAVERS / INVESTORS | The savings nil rate band means that the first £1,000 of savings income is tax free for basic rate taxpayers. This drops to £500 for higher rate taxpayers and to nil for additional rate taxpayers.<br><br>In addition, for individuals that only receive investment income in excess of the personal allowance, the first £5,000 of interest will be subject to the starting savings rate of 0%. | If you are a higher rate or additional rate taxpayer, and you receive large amounts of interest income, consider transferring savings held in your own name to your spouse.<br><br>If you have loaned money to your company, consider paying yourself a commercial rate on the loan to fully utilise these allowances. The company will need to deduct basic rate tax and submit a form CT61 to HMRC. |
| SAVERS | The maximum investment limit for an individual savings account (ISA) is £20,000 per person in 2021/22 for UK residents. Any growth in the ISA is free of both income tax and capital gains tax. | If you have surplus cash, consider utilising some or all of your ISA investment limit. Junior ISAs are also available for children under 18, up to a maximum of £9,000 in the current tax year.<br><br>Advice is recommended before making any investment. |

| WHO IS AFFECTED? | DESCRIPTION | ACTION TO TAKE? |
|---|---|---|
| PARTNERS | As a partner, if you incur business expenses personally and are not reimbursed by the practice, you may be able to deduct them from your taxable profits and reduce your tax bill. Common expenses include motor running costs, funding of capital and working from home costs. | Make a list of all expenses that you have incurred personally, where you believe that there is an element of business usage. Have this to hand to send to your accountant when you submit your tax return information. |
| SHAREHOLDERS | The dividend allowance means that the first £2,000 of dividend income is tax free. | Ensure that you have fully utilised your dividend allowance for 2021/22. If not, consider paying yourself a dividend. Spouse planning may also need to be considered. |
| SHAREHOLDERS | Director/shareholders should review their remuneration package in advance of the tax year, to ensure that it is as tax efficient as possible. | Consider paying a combination of low salary, high interest and high dividends. This could result in tax-free income of up to £20,570 in both 2021/22 and 2022/23 (and double that for couples), depending on the circumstances of the individual. |
| INVESTORS | The capital gains tax annual exemption for 2021/22 is £12,300. Any unused exemption is lost. | Try to use the annual exemption as far as possible.<br>Consider making a transfer of assets between spouses, where appropriate. If the annual allowance has already been used, consider deferring further disposals into the new tax year. |
| INVESTORS | There are various Government-backed investment platforms, such as enterprise investment scheme (EIS), seed enterprise investment scheme (SEIS) and venture capital trusts (VCTs), that give the incentive of income tax relief in exchange for the underlying investment carrying a varying degree of commercial risk. | If you have surplus cash, consider making a tax-efficient investment. Certain conditions must be met to obtain the available tax reliefs, which would need to be carefully considered.<br>Again, investment advice is recommended here. |
| INVESTMENT PROPERTY OWNERS | Mortgage interest relief is now restricted to the basic rate of tax, resulting in a significant increase in the effective tax rates for some landlords, particularly where they are higher earners. | Where you have borrowings attached to rental properties, review your operating structure to see if the arrangements can be made more tax efficient. Options include spousal transfers, use of partnerships or incorporation. |

# Employment taxation – the overseas element?

**The last two years have seen an unprecedented amount of home working, as employers of all sizes have either been encouraged, or forced, to allow their staff to operate from home offices.**

The realisation that home working has commercial and lifestyle advantages for all parties has led to a stepped change in workplace adjustments and recruitment, such that international borders are no longer seen as the barrier they once were. However, where the country of residence of the employer is different from that of the employee, there can be significant complications.

## FOREIGN EMPLOYEE WORKING IN THE UK

An employee who works in the UK for an overseas employer must pay tax and possibly national insurance (NIC) through pay as you earn (PAYE). A common mistake made by foreign employers is to assume that no tax is payable in the UK, provided the employee remains on the payroll of the home country. There are certain relaxations for short term visitors to the UK, but generally PAYE must be operated and tax paid in the UK. If there is no UK presence at all (apart from the employee), the legal responsibility for the correct operation of payroll will usually rest with the employee. This may be an unacceptable risk for that individual and consequently the employer, so care must be taken.

Relief from operating PAYE may be available under the double taxation treaty with the territory in question. The NIC provisions do not mirror taxation though, and if a social security agreement exists, or the individual is from the EU, there may be a temporary exemption, although documentary evidence from the taxation authority is required.

## UK EMPLOYEE WORKING OVERSEAS

Similarly, most countries will expect a UK worker to pay tax and social security wherever the duties are performed. Provided all work duties are performed overseas, HMRC will accept that no tax needs to be collected via the UK payroll, but agreement from them should be sought.

Where a social security agreement is in place with the other country, or if it is in the EU, the employee may continue to pay NIC in the UK for a set period of time rather than overseas, to keep their UK contribution record up to date. After that, it is usually possible for them to make voluntary NIC payments at a reduced rate. Conversely, if the country does not have a social security agreement, or is not in the EU, then NIC will have to be paid for 12 months through the UK payroll.

In most cases, a UK employer will need to appoint a payroll agent in the employee's country of residence to operate a payroll scheme under local tax rules, and make timely payment of deductions to the taxation authority.

## OTHER CONSIDERATIONS

The UK's exit from the EU has meant that it cannot be assumed that a UK employee may simply relocate to another country for work. Non-tax matters such as work permits, registering for local taxes and permission to reside (to name just a few) should be considered.

Individual solicitors looking to work from abroad may also need to register as a foreign lawyer or foreign legal consultant.

We have helped many clients to understand and navigate the complexities involved in working overseas. If you would like to know more, please contact Director, Glenn Collingbourne.

**GLENN COLLINGBOURNE**
01242 680000
glenn.collingbourne@hazlewoods.co.uk

# A look ahead to 2022/23

An awful lot has happened since the last Budget in October 2021, so we thought we would take another look at some of the key points that will impact on law firms in 2022/23.

## 1. NATIONAL INSURANCE/HEALTH AND SOCIAL CARE LEVY

The Budget confirmed that a 'health and social care' levy will be introduced from April 2022, resulting in a 1.25% temporary increase in both the main and additional rates of Class 1, Class 1A, Class 1B and Class 4 national insurance contributions.

From April 2023, the rates will be reduced back to current levels and a new 1.25% health and social care levy will be introduced. The new levy will also be payable by individuals above the state pension age.

| Class | Threshold | Current rate | New rate |
|---|---|---|---|
| Class 1 (primary) | Main rate | 12% | 13.25% |
| | Additional rate | 2% | 3.25% |
| Class 1 (secondary) | | 13.8% | 15.05% |
| Class 1A | | 13.8% | 15.05% |
| Class 1B | | 13.8% | 15.05% |
| Class 4 | Main rate | 9% | 10.25% |
| | Additional rate | 2% | 3.25% |

## 2. CORPORATION TAX

With effect from April 2023, the rate of corporation tax is set to increase to 25% for companies with annual profits over £250,000. Companies with profits below £50,000 will continue to pay the current rate of 19% and companies falling somewhere between the two will pay corporation tax at the main rate of 25%, less a deduction for marginal relief. The closer the company is to profits of £250,000, the closer to 25% they will pay and vice versa.

## 3. ANNUAL INVESTMENT ALLOWANCE (AIA)

The AIA allows firms to deduct the total amount of qualifying expenditure from their taxable profits in a given tax year. It is available to all sole practitioners, partnerships, LLPs and limited companies, but not mixed partnerships (partnerships comprising both individuals and companies) or trustees.

Qualifying expenditure includes spend on assets such as computer equipment, furniture and integral features (assets that are part of a building used for business purposes).

Originally set to reduce to £200,000, the AIA has been held at £1million until 31 March 2023.

## 4. SUPER DEDUCTION

First announced in Spring 2021, the 'super deduction' gives companies additional tax relief when purchasing capital assets. The super deduction allows companies an increased rate of 130% on certain plant and machinery (including computer equipment and office furniture) and 50% on special rate pool assets (e.g. integral features such as lighting and heating systems) on expenditure between 1 April 2021 and 31 March 2023.

# HAVE YOU SEEN OUR LATEST WEBINAR SERIES?

## SRA ACCOUNTS RULES COMPLIANCE WEBINARS

We have a series of free webinars available to view, covering SRA Accounts Rules compliance, factors that might make your accountant's report qualified, and the role of the COFA.

Find out more at:
https://bit.ly/3qQuwAh

# MEET THE TEAM

**JON CARTWRIGHT**
Partner
01242 237661
jon.cartwright@hazlewoods.co.uk

**PATRICIA KINAHAN**
Partner
01242 237661
patricia.kinahan@hazlewoods.co.uk

**ANDY HARRIS**
Partner
01242 237661
andrew.harris@hazlewoods.co.uk

## SIGN UP TO RECEIVE OUR BUSINESS UPDATES

Hazlewoods LLP and Hazlewoods Financial Planning LLP produce regular updates, using our expert commentary to provide you with information about our services, events and topical premium business news.

SIGN UP/UPDATE ONLINE: **http://bit.ly/hazlewoods**


Windsor House, Bayshill Road, Cheltenham, GL50 3AT
Tel. 01242 237661
www.hazlewoods.co.uk / @Hazlewoods


HAZLEWOODS
DRIVING LIFELONG PROSPERITY



HLB
WE ARE AN INDEPENDENT MEMBER OF
THE GLOBAL ADVISORY AND ACCOUNTING NETWORK