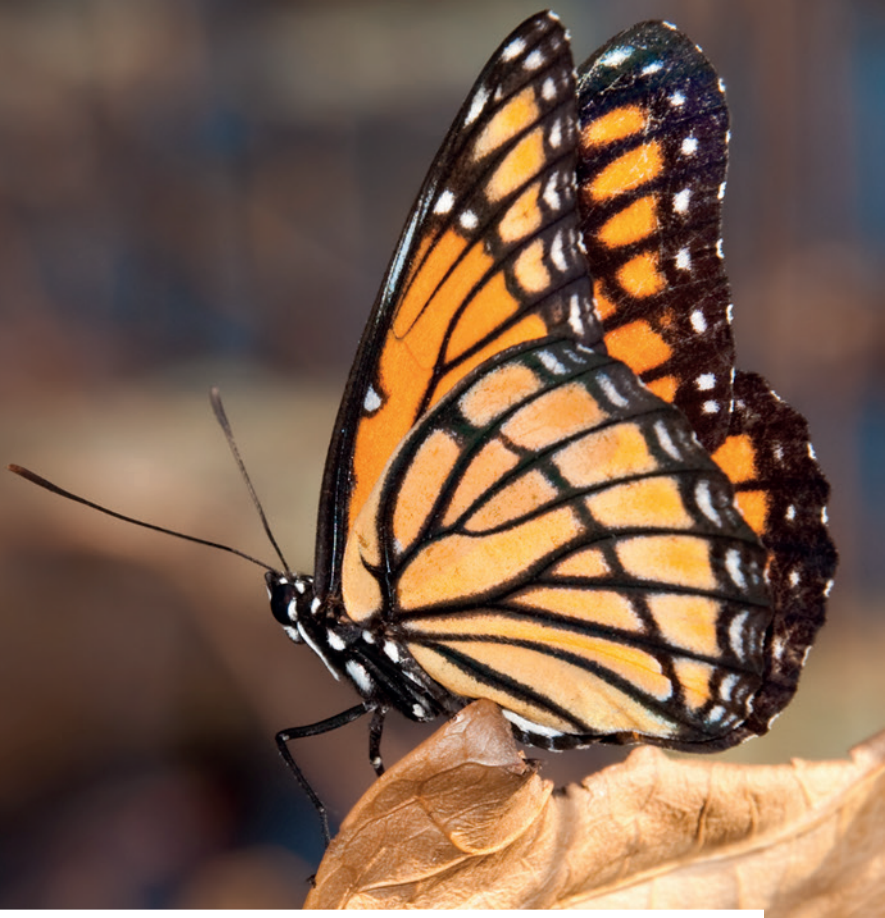
Talking Tax

DRIVING LIFELONG PROSPERITY

Autumn 2021

SPOTLIGHT ON INCOME TAX REGIME CHANGES



Welcome...

Our autumn issue of Talking Tax brings a spotlight on the significant proposals ahead for the income tax regime. This is potentially the biggest shake up to the regime in decades and could lead to accelerated and higher tax liabilities for many individuals as a result.

We also take a look at the detail behind the recent announcement to raise NIC and dividend tax rates, the practicalities of the new super deduction for companies and present a Q&A with tax partner, Tom Woodcock, on the new trend of employee ownership.

Finally, as some normality begins to resume and COVID-19 support measures start to wind down, we give a reminder of the eligibility criteria for each of the SEISS grants to confirm entitlement.

INSIDE

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Income tax shake up

Some significant changes are ahead for income tax in the next few years. Some of these have been expected and known for a while but some are recent, surprise announcements by the Government.

All of these changes, however, are interlinked and are ultimately heading towards more timely reporting of income tax liabilities and, most likely, accelerated tax payments in the not too distant future.

MTD FOR INCOME TAX

Making tax digital (MTD) for income tax was expected to first apply for accounting periods beginning on or after 6 April 2023 for unincorporated businesses and landlords with total gross income of more than £10,000. In an announcement made on 23 September, however, it was confirmed that this commencement date would be pushed back one year to April 2024 and until April 2025 for general partnerships.

Gross income will be calculated in aggregate meaning that if you have, say, £6,000 from self-employment and £5,000 from property rentals, you would be required to comply with the new filing requirements.

Under the new rules, individuals will be required to submit quarterly reports summarising income and expenditure to HMRC using making tax digital (MTD) compatible software.

For most individuals, the best way to maintain digital records and submit MTD filings will be via some form of cloud-based accounting software. Keeping spreadsheet records may become a thing of the past, although there may be some possibilities to continue to use them alongside a bridging software.

If you are using traditional desk based software, spreadsheets or older versions of cloud software, now may be a good time to start looking at possible upgrades or new software, in plenty of time to ensure that you will be compatible.

BASIS PERIOD REFORMS

With MTD for income tax on the horizon, the Government has introduced proposals to reform basis periods for individuals and partners, so they are taxed on profits arising in the tax year rather than the profits based on the accounting year end. Effectively, this change will only impact self-employed individuals and partners who do not prepare their accounts to 31 March or 5 April.

The rules were expected to apply from April 2023 but with the delay to MTD, this will now be April 2024 at the earliest with a transitional period commencing from 2023/24. The change is likely to lead to an acceleration of tax, as profits will be brought into account earlier and is best explained using an example.

Fred is a partner in a partnership which draws up its accounts to 30 April each year. For the accounting period to 30 April 2023 his profit share is £50,000 increasing to £60,000 in the 12 months to 30 April 2024. He has overlap profits brought forward of £15,000.

In 2023/24, the transitional year, he will be taxed on the following profits:

	£
Profit share to 30 April 2023 (as currently)	£50,000
Plus: Transition profit for the period 1 May 2023 to 5 April 2024: £60,000 x (11/12)	£55,000
Less: overlap profit brought forward	(£15,000)
Taxable profits for 2023/24	£90,000

In the example above, Fred's taxable profits for 2023/24 will almost be doubled, however, the proposals do also include provisions to spread any excess profits (as a result of the transitional rules) over five years. Therefore, in the example above, the additional £40,000 of profits assessed could be taxed over five years, at £8,000 per year. After the spreading election, this would give revised taxable profits for 2023/24 of £58,000.

Assuming that this is the only income that Fred has, not only will he have a higher tax bill in 2023/24, as a result of the additional profits assessed, he will also be tipped into the higher rate tax band, paying 40% tax on much of those additional profits rather than his standard marginal rate of 20%.

In 2024/25, Fred would be taxed on the remaining 1/12th of his profits for the period to 30 April 2024, plus 11 months of profits for the following accounting period, along with £8,000 under the spreading provisions.

Another complexity is that the filing deadline for the 2023/24 tax return will remain as 31 January 2025. This would give a business with a December year end just one month to finalise accounts for the 12 months to 31 December 2024 and allocate profits accordingly to the period to 5 April 2024. In such cases, estimates may be required instead, which could entail amending returns at a later date. Some other options have been suggested to deal with this issue in the consultation, but exact provisions are yet to be finalised.

For simplicity, many may look to change their accounting period in line with the tax year but timing of this should be considered as it could still result in an accelerated tax liability, but without the option to spread this over five years if changed too soon.

TIMELY PAYMENTS

The elephant in the room is the next step HMRC are likely to take once MTD for income tax has bedded in. With information being provided to HMRC on a more regular basis, the obvious progression will also be to accelerate tax payments. Currently, final tax liabilities are not due until 10 months after the end of the tax year and could relate to an accounting period ending much earlier.

HMRC has already issued a consultation on this very topic and it considers increasing the frequency of payments, as well as accelerating payment deadlines. Although this is in the early stages and no firm proposals have yet been confirmed, we would anticipate that the most likely route will be to move towards quarterly payments, in line with MTD filings, and much closer to real time.

The main concern with this is that quarterly reports under MTD are unlikely to give a true view of the final tax position, as they will not take into account allowances, reliefs or other events that occur later in the tax year. Any 'in-year' tax payments may, therefore, be largely reliant on estimates.

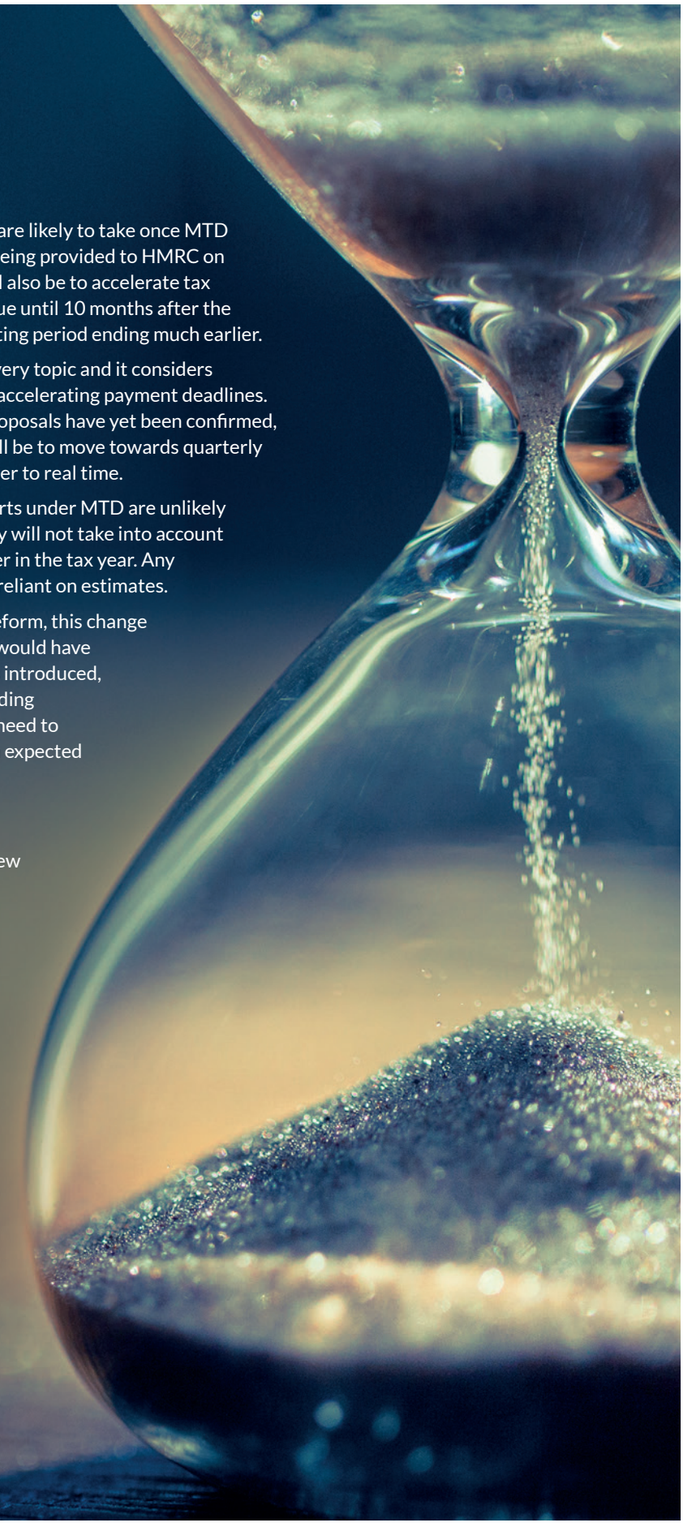
Further, and as explored with the basis periods reform, this change would again lead to an acceleration of tax which would have cashflow implications. Depending on when this is introduced, taxpayers could still be under the five-year spreading transitional provisions, which could result in the need to source funds to settle an even higher tax bill than expected and at higher tax rates.

TAX YEAR REVIEW

One final spanner in the works is an ongoing review with the possibility of changing the tax year end. Suggestions include changing the year end from 5 April to 31 March which would have minimal overall impact.

A more controversial proposal, however, is to change the tax year end to 31 December. This would clearly impact the above proposals and businesses may find themselves in the position of looking to change their accounting periods once again.

It is hoped that the decision of a change in the tax year, if any, is announced in conjunction with the other changes discussed above to reduce uncertainty and prevent multiple changes of year ends as a result.



ADVISING YOU THROUGH THE TRANSITION TO EMPLOYEE OWNERSHIP

A Q&A with Tom Woodcock, Partner at Hazlewoods

WHAT IS KEEPING YOU BUSY LATELY?
I am currently helping a number of companies with the transition to employee ownership. This is becoming an increasingly popular route for business succession, with the commercial and tax benefits of transitioning to employee ownership being wide reaching and making it a very attractive proposition.

HOW COULD EMPLOYEE OWNED BUSINESSES HELP BOOST THE UK ECONOMY?
There is a lot of research available suggesting that employee owned businesses are generally more productive, their employees are more engaged and, as a result, financial performance is improved. With employees having a say in how the business is run, and linking performance to rewards, it is easy to see how this may be the case.

WHAT SHOULD CLIENTS THINK ABOUT BEFORE CONSIDERING AN EMPLOYEE OWNED BUSINESS?
Transitioning to employee ownership is not straightforward and there are a lot of factors to consider and steps to take. My advice is to start the conversation around business succession early, allowing plenty of time to look at the options to determine the most appropriate exit route for you and your business.

TELL US SOMETHING THAT WE MIGHT NOT KNOW ABOUT YOU?
I am an amateur racing driver and own a 1964 MGB race car, travelling across the length and breadth of the country to race whenever I can. I have also caught the cycling bug in recent years and have fully embraced lycra! My greatest achievement to date was climbing four Tour de France alpine climbs over four days, whilst raising money for our charity of the year in the process.

For more information on employee owned businesses, including advice on whether it could be a suitable model for your business, please get in touch with Tom at tom.woodcock@hazlewoods.co.uk or 01242 237661.

SEISS SUPPORT PAYMENTS – CONFIRMING ELIGIBILITY

As the self-employed income support scheme (SEISS) has evolved and more grants have been introduced, the eligibility criteria has also changed. With the deadline for claiming the fifth and final grant closing on 30 September, now is a good time to take stock and check that you have correctly claimed. As a quick recap, for grants one and two the eligibility conditions were as follows:

- A self-assessment tax return for the 2018/19 tax year was submitted by 23 April 2020
- You were self-employed or a partner in a partnership during the 2019/20 tax year and traded for at least part of that year
- Your profits from self-employment or partnership share were £50,000 or less and were equal or more than your non-trading income
- You carried on a trade that has been adversely affected by COVID-19.

The only subjective criteria for claiming this grant, therefore, was the final point above, which for many businesses would be easy to satisfy particularly during the first part of the pandemic.

The third and fourth grant introduced some additional eligibility criteria including:

- You are actively continuing to trade but are facing reduced demand due to COVID-19 in the qualifying period; or
- You were previously trading but are unable to do so, temporarily, due to COVID-19; and
- You must reasonably believe that you will suffer a significant reduction in trading profits for a relevant basis period (usually your accounting period).

As a result of these new conditions, it was necessary for many to determine whether the above would be satisfied prior to the relevant accounting period ending. If by the end of the accounting period there had been an upturn in profits, it would not automatically mean that you now need to repay the grant. Providing that you have some evidence that, at the point of claiming the grant, there was a reasonable belief that trading profits would be significantly reduced, this should suffice. You may of course, however, decide that you wish to repay the grant following an unexpected upturn in profits, even if you have supporting evidence for a valid claim.

In addition to the above criteria, the fifth and final grant added further complexity with a new 'turnover' test. In this case, the amount that could be claimed was dependent upon your turnover for a 12 month period, broadly commencing from April 2020 compared to your turnover as per your filed 2019/20 tax return (and in some cases looking back to 2018/19 where 2019/20 was not deemed to be a normal year).

The turnover calculations and associated reference periods were not as straightforward as expected and further details can be found in our article at https://bit.ly/3xA9J3O

If you have any concerns as to whether you were eligible to claim some or all of the SEISS grants, please do get in touch with your usual Hazlewoods contact.

PRACTICALITIES OF THE NEW SUPER DEDUCTION

As part of the Chancellor's Budget 2021 speech, a 'super deduction' was announced for companies investing in qualifying plant and machinery. We have set out a recap of the relief and qualifying expenditure as well as a last-minute change to the legislation and some other practical considerations.

THE RELIEF

The super deduction allows companies to claim 130% capital allowances for capital expenditure on qualifying plant and machinery purchased between 1 April 2021 and 31 March 2023. The Budget also announced a 50% rate for special rate capital expenditure (e.g. on integral features such as electrical, heating and lighting systems).

For example, if a company purchased new machinery costing £100,000, capital allowances will be available on an enhanced figure of £130,000. At the current rate of corporation tax of 19%, this will result in total corporation tax relief of £24,700, £5,700 of which being an additional tax reduction.

The relief is only available to companies and not unincorporated businesses. The reason behind this appears to be to effectively offer 25% tax relief on new capital investments now, prior to an increase in the standard corporation tax rate for companies to 25% from 1 April 2023, to avoid companies deferring capital investment.

QUALIFYING EXPENDITURE

Typical expenditure which qualifies for the enhanced rate includes new computers, office furniture, machinery, tools, software and vans. Specifically excluded expenditure includes purchases of second-hand assets, cars, long life assets and plant and machinery which would qualify for special rate capital allowances (e.g. integral features such as electrical, heating and lighting systems).

A 50% first year allowance (rather than the current 6% writing down allowance) was also announced for special rate expenditure on integral features which is not eligible for the new 'super deduction'. In reality, however, it is likely to be more beneficial for most companies to instead claim the annual investment allowance (AIA).

The AIA provides 100% relief for expenditure incurred up to £1 million until 31 December 2021, before reducing to £200,000 thereafter. The 50% allowance could become of use if the AIA allowance for the relevant period is exceeded, which may be relevant for large groups and/or significant new capital projects.

AN EXTENSION FOR LANDLORDS

As set out above there are a number of specific exclusions from both of these reliefs, which also originally included expenditure on plant and machinery used in leased buildings. Since the original announcement, however, an amendment was made to the draft legislation (which has now been enacted) to allow such expenditure.

Under the revised legislation, a company that purchases or constructs a commercial building to lease out, will now also be eligible for enhanced relief on any qualifying fit out expenditure.

OTHER POINTS TO CONSIDER

Timing is key as there will be an apportionment of the relevant super-deduction percentage that applies to expenditure incurred in an accounting period that straddles 1 April 2023. Further, if an asset for which a super deduction is claimed is then subsequently disposed of prior to 31 March 2024, the disposal proceeds will also need to be grossed up by up to 130%.

As a result of the enhanced relief, the company may find itself in a loss position for tax purposes. Under temporary rules, which allow an extended loss carry back to the three previous years (compared to the normal carry back loss rules of just one year), this loss could be used to secure a substantial tax refund. This should, however, be weighed up against the benefit of carrying the loss forward to post April 2023 when corporation tax rates will be higher.

HIKE IN NATIONAL INSURANCE AND DIVIDEND TAX RATES ANNOUNCED

The Prime Minister has announced an increase in both national insurance contributions (NIC) and dividend tax rates from next April to help fund the Government's health and social care reform.

Boris Johnson has had to break his manifesto pledge of not increasing income tax, national insurance or VAT rates during his parliamentary term to bring in this change. His justification for doing so, however, is that they could never have predicted the global pandemic when making this pledge. Further, he could also argue that the NIC increase is only a temporary measure, as it will be classified as a new tax from April 2023.

THE KEY ANNOUNCEMENTS

From April 2022, NIC rates are to rise by 1.25%. This will be for both class 1 employer's NIC **and** class 1 employee's NIC so effectively a 2.5% increase in total. The rise will also apply to class 4 NIC for the self-employed (but not class 2 or class 3 NIC). The increase will be applied to the main and higher rates.

From April 2023, the NIC rates will reduce back to current levels and a new tax, known as the 'Health and Social Care Levy', will instead apply at a rate of 1.25% on earned income. This will be shown as a separate entry on an employee's payslip. From this date, the new levy will also apply to individuals working above state pension age.

Dividend income tax rates are also rising by 1.25% from April 2022, with new rates as follows:

- Basic rate: 8.75% (up from 7.5%)
- Higher rate: 33.75% (up from 32.5%)
- Additional rate: 39.35% (up from 38.1%)

When the dividend rates increased last time, the s455 tax on directors' loans also increased in line with the higher rate band, to 32.5%. Although there is nothing specific in the detail published by the Government referencing this, it would be of no great surprise if it is also increased to 33.75%, at the upcoming Autumn Budget on 27 October 2021.

SOCIAL CARE PLAN

The Government estimates that the new measures will raise £12 billion per year. The additional tax raised, it is said, will be ringfenced to help pay for the impact on the NHS from the COVID-19 pandemic, as well as fund the Government's social care plan which, with effect from October 2023, will include the following:

- Anyone starting care in England will be subject to a lifetime cap spend of £86,000 on social care. However, the cap only applies to 'physical care' and not to daily living costs, such as food, energy bills and the accommodation. Furthermore, it is probable that only the frailest of individuals will qualify.
- Anyone with assets of less than £20,000 may need to make a contribution from their income but will not have to pay anything for their care costs from their assets.
- Those with assets of less than £100,000 will have subsidised care costs under means-tested support. Individuals will still be required to pay for their care costs from their income but, if that is insufficient, will also be required to contribute up to 20% of the total value of their assets per year.

PLANNING AHEAD

With the change effective from April 2022, it may be worthwhile to plan ahead now and look at whether dividends and/or bonuses can be paid prior to the end of the tax year, before the rate increases take effect.

TAX ENQUIRIES – ARE YOU COVERED?

Statistics have revealed that HMRC opened 36% more enquiries in the first quarter of 2021, compared to the previous quarter.

These statistics are not entirely unexpected as there was a noticeable drop in the number of enquiries last year, with the ongoing pandemic and resource being shifted to help administer the furlough scheme.

As the furlough scheme begins to wind down, however, and the number of employees being furloughed dramatically reduced, signs of HMRC returning its resource and attention to tax investigations have not gone unnoticed.

Our new Tax Investigation Service period commences on 1 November 2021, so look out for your renewal invoice or invitation letter to join the service in the coming weeks. The Tax Investigation Service will pay our professional fees that result from most types of HMRC investigations should you be selected for an enquiry.

If you would like further information on the service, please speak to your usual Hazlewoods contact or Fiona Isherwood on **01242 680000** or **fiona.isherwood@hazlewoods.co.uk**.

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