Talking Tax

DRIVING LIFELONG PROSPERITY

Winter 2018

SPOTLIGHT ON THE BUDGET

Welcome...

with continued uncertainty as Brexit looms closer, the Chancellor's Budget speech was widely expected to be something of a damp squib. Surprisingly, however, a number of new tax changes were announced as well as some significant pledges for spending. In this issue, we look at some of the key announcements in a bit more detail.

With no mention in the Budget of Making Tax Digital for VAT, we look at where we are now and if it is still full steam ahead for April 2019.

We also take a step back and look at the minefield for property owners in determining the best ownership structure for trading premises and give a reminder of some simple but effective inheritance tax planning ideas.

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Budget summary – key tax changes

THE GOOD

For individuals, the tax-free personal allowance will increase to £12,500 and the higher rate band to £50,000 for 2019/20. Hammond confirmed that they would be delivering on their manifesto pledge one year earlier than expected with tax savings of between £130 and £860 for a basic rate taxpayer.

Companies will benefit from 100% tax relief under the Annual Investment Allowance for purchases of qualifying capital expenditure of up to £1 million per annum for two years from 1 January 2019 (currently £200,000).

THE BAD

Where an individual sells their home they are currently entitled to principal private residence relief (PPR) to ensure that the final 18 months of ownership is exempt from capital gains tax, even if they have since moved out. From 6 April 2020, this period will be halved to nine months, meaning that owners will have to sell their homes quicker if tax is to be avoided.

A further relief applies where the property was a residential let for part of the time it was also the owner's PPR. This relief is worth up to £40,000 and double this for a couple. From 6 April 2020, this relief will only apply in the case of a shared occupancy i.e. where the owner lets out part of the house to lodgers.

AND THE UGLY!

Hammond announced that he would be ignoring calls to abolish entrepreneurs' relief (ER) as the government recognised it was important to the economy to continue to back entrepreneurs.

During his speech he announced that the rules would be tightened slightly by extending the qualifying ownership period from one year to two years for disposals on or after 6 April 2019. However, when delving in to the detail there was more!

The draft legislation also included amendments to the definition of a 'personal company' to include that any disposals of shares on or after the Budget date (29 October 2018) will only qualify for ER if they are also beneficially entitled to at least 5% of the distributable profits and at least 5% of the assets available on a winding up. This is in addition to the existing requirement to hold at least 5% of the share capital and 5% of the voting rights.

This change, if it is to go through as drafted, could impact on a large number of companies. Being able to demonstrate that for every day in the two years prior to sale, the individual was entitled to 5% of the assets on a winding up could prove difficult, particularly where the company has debt that is not third-party bank debt, including some director's loan accounts or preference shares.

Further, companies with different classes of shares that have differing dividend rights could be impacted by the new requirement to be entitled to 5% of distributable profits.

HMRC CROSS-TAX ENQUIRIES

HMRC appears to be increasingly taking the decision to raise cross-tax enquiries for companies. This means that, rather than opening an enquiry into a single area such as corporation tax or VAT, HMRC is instead choosing to look across all taxes in one fell swoop.

Receiving a letter from HMRC notifying their intention to carry out a cross-tax check can be a daunting prospect. With detailed queries and requests across corporation tax, PAYE and VAT, the enquiry process can inevitably be time consuming and complex.

The first steps, however, are to understand what HMRC is trying to achieve from the process, asking what risk profile they have attached to the business, and exploring how their concerns can be best addressed with minimal impact to the business.

We can of course help with this process and if you are part of our Tax Investigation Service, our costs for doing so will also be covered.

VAT AND MTD

Making Tax Digital for VAT (MTDfV) has been a known entity since the summer of 2017, but the lead in process has been quite drawn out. It is only relatively recently that the details have been fleshed out and software providers have begun to demonstrate their systems ahead of the 1 April 2019 commencement date.

It has now been confirmed that HMRC will delay the implementation of MTDfV for 'more complex' businesses for six months, with the go live date for mandatory use for certain organisations being deferred to 1 October 2019. As such, trusts, unincorporated charities, public corporations, overseas businesses who are UK registered but who have no establishment in the UK, and companies who use group or divisional registrations, make payments on account, or use the annual accounting scheme are all now deferred.

Shortly before going to print, the House of Lords published a report calling for a delay in implementation of at least 12 months. However, they also commented that HMRC and the government have failed to listen to concerns to date and so, for now, the move to MTDfV continues apace. Whether your go-live date is 1 April or 1 October next year, time is running out to prepare for what will be quite large-scale changes to the reporting regime. Does your current accounting process allow MTDfV to be implemented easily? What data will you need to share with HMRC, and how confident are you in the quality of that data? Do you need any extra software in order to enable MTDfV for your business?

Hazlewoods can assist you in assessing how prepared you currently are for MTDfV, and help identify any areas where you may still need to prepare. Our experts can discuss your software needs with you, helping to identify any breaks in the digital links that MTDfV requires, and supporting you to bridge those gaps. Where MTDfV may be onerous or impractical, we can assist in negotiating with HMRC to find alternative working methods.

COMPANY CAPITAL LOSSES

As part of the 2018 Budget, it was announced that rules introduced in April 2017 for the utilisation of carried forward corporation tax (CT) income losses would also be extended to a company's capital losses.

CURRENT RULES

Since April 2017, carried forward corporation tax income losses have only been available for offset against 50% of profits. A deductions allowance of £5 million is, however, available with the restriction only applying above this de minimis.

EXAMPLE

BROUGHT FORWARD LOSSES		CURRENT YEAR PROFITS	
CT income losses	£5.5 million	CT income profits	£5 million
CT capital gains losses	£2 million	CT capital gains	£2 million
Total losses	£7.5 million	Total profits	£7 million

In the above example, no CT liability would arise as the income profits are within the deductions allowance and capital gains are excluded from the regime with sufficient losses to offset.

EXTENSION TO CAPITAL LOSSES

From April 2020, however, capital losses will also be required to be taken into account and subject to the 50% restriction.

Using the same example above, it is anticipated that only £6 million of losses would be available for offset (i.e. £5 million plus 50% of £2 million), leaving £1 million subject to corporation tax under the new rules.

The 2017 rules for income losses also brought about some increased flexibility for the use of losses, however, as there are already some provisions in place for group relieving capital losses, there will be no further changes in this regard.

OFF-PAYROLL WORKING – QUELLE SURPRISE?!

A consultation released earlier this year looked at off-payroll working in the private sector. A number of possible options were put forward to tackle the perceived abuse of personal service companies (PSC), commonly known as the IR35 rules.

The cynics amongst us, however, believed that this was all a formality and it was inevitable that the government would favour a mirror of the new public sector rules. It was, therefore, not much of a surprise when the Chancellor did indeed announce at the Budget that this was the route to be taken.

The IR35 rules work by determining whether the individual operating through a PSC would be regarded as an employee if directly engaged. Under rules to be introduced from April 2020, the onus will be shifted from the PSC to the private sector company to determine whether IR35 applies.

The private sector business will then be required to deduct PAYE and NIC from payments made to the PSC, if they deem appropriate.

There will be some reprieve for smaller private sector entities, who will not be within the scope of the new rules, but further detail is awaited to confirm the limits that will be applied for this.

TRADING PROPERTY OWNERSHIP

The decision as to whether to acquire business premises personally or via a company will be dependent upon a number of different factors. This includes commercial considerations such as financing options and legal protection, relevant tax charges and available reliefs, as well as longer-term plans for a potential future sale of the business.

We have summarised below some of the considerations and tax implications of the three most common holding structures below.

	HELD PERSONALLY	HELD BY TRADING COMPANY	HOLDING COMPANY OF TRADING GROUP
Legal protection	Separate from the trade and therefore protection in the case of insolvency	No protection from the trade i.e. would form part of the assets available to creditors in insolvency.	Protection from the trade as a separate legal entity.
Taxation of income	Any rent received will be subject to income tax at the individual's marginal rate but interest costs will be deductible. Rent paid by the company is a tax-deductible expense.	Profits of the trade subject to corporation tax at 19% but relief given for finance costs for the business premises. Additional tax will be due on distribution of profits but flexibility around timings and amounts paid up.	Rental income received by the holding company will be subject to corporation tax but tax-deductible expense in the trading company. Relief for finance costs in the holding company.
Capital gains tax on disposal of property	Gain on disposal taxed at either 10% or 20%. Annual exemption available for offset, currently £11,700 (£12,000 for 2019/20).	Gain subject to corporation tax on disposal of the property with no annual exemption available.	Gain subject to corporation tax on disposal of the property with no annual exemption available.
Capital gains tax (CGT) on disposal following cessation or withdrawal from the business	Entrepreneurs' relief (ER) giving a 10% CGT rate should be available, but may be restricted where there has been an element of non-business use or if the company has paid rent for use of the property.	ER may be available in respect of disposal of the shares in the trading company.	ER may be available on disposal of shares if being sold as the holding company of a trading group, or within three years of the group ceasing.
Inheritance tax (IHT)	50% business property relief (BPR) may be available, such that only half of the value of the property will be potentially subject to IHT.	100% BPR may be available such that the shares in the business (including the property) can be passed on free of IHT.	100% BPR may be available if it is a holding company of a trading group.
Other considerations			Added admin and associated costs with an additional group company but flexibility for potential disposal of the business without the property.

As can be seen from the above, there are tax advantages of both personal and company ownership, so it often is not clear cut as to the best approach to take and it will likely be down to a combination of factors.

If considering a change in the ownership of an existing business property, there could be additional tax charges including stamp duty land tax and capital gains tax to pay, so again careful consideration should be given to these.

IHT PLANNING AND WILLS

Recent research carried out by Hazlewoods, found that we are a 'live for today' nation. Almost two-thirds (64%) of people surveyed said their priority was to have enough money to live the lifestyle they choose now ahead of planning for their children's inheritance and their future care.

However, some simple planning could help to ensure the best of both worlds, by continuing to enjoy the life you are accustomed to today, whilst also putting in place plans for future generations.

Some simple areas to consider include:

WILLS

Ensuring that a Will has been made and has been drafted tax efficiently. Once made, periodic reviews should be carried out and updates made for any changes required. This could be due to a change in family circumstances or changes in legislation.

One example of this could be to take advantage of the residence nil rate band (RNRB) recently introduced to enable the family home to be passed on to direct descendants (e.g. children, grandchildren etc.).

PENSIONS

The 2015 pension's reform brought about increased flexibility for pensions. The changes included allowing unused pensions to be tax free (if death occurs before the age of 75) or taxed at the marginal rate (if death occurs after the age of 75) as drawn down by the person inheriting. Previously, unused pensions were taxed at 55%. The pension pot will also fall out of an individual's estate for inheritance tax purposes.

Coupled with the tax relief available for making pension contributions, this can prove a tax efficient way to pass on income to future generations, whilst reducing the value of your estate..

NIL RATE BAND

Based on current rates, the first £325,000, of an individual's estate (known as the nil rate band (NRB)), will not be subject to inheritance tax (IHT). Utilising the NRB by making chargeable lifetime transfers of £325,000 and other (potentially exempt) transfers of more than this. These will fall out of account after seven years.

IHT EXEMPTIONS

Certain gifts made during your lifetime are exempt from IHT. This includes gifts between spouses, charitable donations, a £3,000 annual exemption, small gifts of up to £250 and wedding gifts (up to certain values).

IHT RELIEFS

There are two main reliefs from IHT, business property relief and agricultural property relief. These reliefs effectively remove the value of many business interests and farms from the charge to IHT.

Ensuring that your business qualifies for relief is key, as the position is not always straightforward. Some simple planning as to whom the business is left can also ensure significant IHT savings. This could include leaving business assets to your children or the use of a trust.

IHT PLANNING AND WILLS CONTINUED

GIFTS TO CHARITY

Providing for a charitable legacy in your Will could reduce the applicable IHT rate from 40% to 36%. At least 10% of the value of the net estate at the date of death must be gifted to charity.

USE OF TRUSTS

Lifetime transfers into most trusts are chargeable to IHT. If the chargeable trust assets are greater than the available NRB, IHT charges will arise on gifts into the trust, every ten years and when the assets exit the trust.

The IHT charges in trusts are still lower than death rates, so trusts with assets greater than the NRB can still be useful in IHT planning and certainly for asset protection.

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