Spring 2015

inside

Baxter&Co
CHARTERED CERTIFIED ACCOUNTANTS

Year End Tax Review 2014/15

With your tax return filed for 2013/14, it is time before the end of the tax year on 5 April, to undertake an annual review of your financial affairs to check if you are paying more tax than you need to and whether the structures you set up in the past are still appropriate.

IN THE NEWS

Tax avoidance is very much in the news again and we can expect to hear even more about it as the election approaches. But what is tax avoidance?

Everyone is clear that deliberately concealing income and gains is wrong. That is what we call tax evasion. Transferring money to an overseas bank account with no intention of declaring the income and gains arising, is tax evasion. Transferring money to an overseas bank account, but declaring the income and gains arising, is neither tax evasion or avoidance.

So what is tax avoidance? At its simplest, tax avoidance is the use of legal methods to modify your financial situation in order to reduce the amount of tax payable on any given level of income or gains. This is generally done by claiming the permissible reliefs and allowances. So putting money into an ISA or pension, is tax avoidance.

The government takes the definition a step further. They distinguish between acceptable tax planning, which is the entitlement of any individual to organise their affairs in such a way that they do not pay more tax than they need to, and tax avoidance, which is using tax reliefs and allowances in a way that was not intended.

At the extremes we can all distinguish what is and what is not acceptable tax planning. Using an ISA clearly is acceptable, entering into a scheme, for example to take advantage of the reliefs for the film industry using partnerships and loans where there is no real economic risk being taken, is not. In between the extremes it can become very murky. It is often unclear as to the intent of parliament in passing tax law, and in many cases it is left to the courts to decide, which may not happen for many years. Undoubtedly many of the individuals who took up tax schemes five, six or more years ago, which are only now coming before the courts, genuinely believed that what they were being offered was legitimate and acceptable tax planning.

All the time the government is introducing new reliefs and revising old reliefs. For example this year the government has introduced new reliefs for investing in social enterprises, and for passing control in a company to its employees. This latter relief can allow an individual to realise the value of his company without paying any tax, which opens up new planning opportunities.

What is certain is that the debate on tax avoidance will continue and whichever party, or combination of parties, forms the next government, we will almost certainly see yet more measures to tackle perceived abuses.

In this newsletter we set out a number of tax planning ideas that HMRC should not object to – they involve straightforward use of reliefs in a way the law intended.

Tax law changes all the time; this newsletter is based on the tax law as it stands today. Of course, the precise circumstances of each individual have to be taken into account in deciding whether any particular plan is suitable or advantageous – but these suggestions may give you some ideas. We'll be happy to discuss them with you in more detail.

NISA WAYS TO SAVE

Most people need to save for something: university fees, retirement, house repairs, or just an 'emergency fund'. For a long-term goal, a pension scheme may be the best vehicle. New Individual Savings Accounts (NISAs) give shorter-term access to your money as well as tax breaks.

Each UK resident adult can deposit up to £15,240 in a NISA from 6 April 2015 (limit was £15,000 from 1 July 2014). The investments in the NISA can be held in stocks and shares, or in cash, in any proportion you determine. Income and capital gains arising in any kind of ISA are tax-free.

A person aged 16 or 17 can open a cash ISA, investing up to £15,240 in 2015/16 (£15,000 for 2014/15). Beware of making significant contributions to your child's ISA if they are still under 18, because if you provided the funds and the interest exceeds £100 p.a., that will count as your taxable income, not your child's tax-free income.

A 'Junior ISA' can be opened for any UK resident child aged under 18 if they don't have a Child Trust Fund (CTF) account. Anyone, even the parents, can deposit up to £4,080 into the child's junior ISA in 2015/16 (£4,000 for 2014/15) without tax charges. From 6 April 2015 it will be possible to transfer funds from a CTF to a Junior ISA.

You can switch your savings between different NISA providers, if you ask the manager to do this for you.

TAX CLIFF EDGES

When your total income reaches certain thresholds, it tips any extra income into a band where a higher rate of tax is charged. This can happen at some unexpected points due to the withdrawal of allowances or the claw-back of benefits.

If your total income in this tax year or the next year is expected to hover around one of the cliff edges, you could save money by moving income or deductions from one year to the other.

For example, if you are a 20% taxpayer in 2014/15, but expect that a bonus in March 2015 will tip you into 40% tax for this year, you could ask your employer to postpone the bonus payment until after

5 April 2015. You'll pay the tax on that income later, and you may stay out of the 40% band as the 40% threshold will be higher for 2015/16.

If your income falls in the band in which your personal allowance is withdrawn (£100,000 to £120,000), your marginal income tax rate is effectively 60%, plus 2% national insurance. For child benefit clawback the marginal rate can be much higher, depending on the amount of benefit received. This makes the tax saving on shifting income or deductions even more valuable.

Income that can easily be moved from year to year includes:

- bonus or salary from your own company
- dividends from your company
- distributions from discretionary trusts

It's also possible to adjust the timing of deductions for Gift Aid charity donations or pension contributions from year to year, as these can increase the value of a threshold that tips you into the higher tax rate.

GIVE AND SAVE

Giving to charity can result in a win/win for both the donor and the charity where the gift is made under Gift Aid.

A Gift Aid donation will reduce the tax payable for the year in which the gift is made, but it is possible to shift that tax benefit back a year. This can only apply if the gift precedes the filing of the tax return for that earlier year. For example, a gift made on 31 October 2015 can reduce the 2014/15 tax liability which is due on 31 January 2016, if the 2014/15 tax return is submitted after 31 October 2015.

Gift Aid can also reduce your income used to calculate the clawback of child benefit (income over £50,000) and the reduction in personal allowances (income over £100,000). Gift Aid doesn't affect the cap on setting losses against other income (income over £200,000). To avoid the loss relief cap, advancing a pension contribution may be a better option.

Giving quoted shares or land produces both income tax and capital gains tax (CGT) reliefs. Suppose you give shares worth £50,000. This generates an income tax reduction of £20,000 (for a 40% taxpayer). If the shares would otherwise produce a taxable gain on disposal of, say £16,000 (after your CGT annual exemption), you can also save CGT at 28%, that's £4,480. So the charity receives £50,000 for a cost to you of only £25,520.

FAMILIES

In the UK everyone is taxed as an individual, but social security benefits are awarded on the basis of the family's income. This is contradictory and confusing, but we have to live with the law as it is.

The result is that families with an unequal distribution of income will often pay more tax than couples who earn enough each to cover their basic personal allowance (£10,000 for 2014/15) and basic rate band (£31,865 for 2014/15).

Consider the Browns, who are married with two children and claim child benefit. In 2013/14 George Brown earns £80,000 and Sally Brown has no income. After paying tax and NI of £26,636, the family has net income of £53,364. However, as George's income is over £60,000, the child benefit of £1,752 is clawed back as a tax charge, making their net income £51,612. As an alternative to the child benefit tax charge, Sally can ask HMRC not to pay her the child benefit, but to keep her claim 'live' so she receives NI credits that count towards the state pension.

In 2014/15 the Browns both work part-time, each earning £40,000, just below the higher rate threshold. After paying tax and NI of £9,845 each, the family takes home £60,310, but as neither parent has income above £50,000, they keep the child benefit of £1,770.

These examples show that it makes sense to transfer some income from the higher earner to the lower earner in order to take advantage of the tax-free allowance and lower-taxed slices of income. This is not always easy to do, but the following methods are possible:

- an outright gift of savings and investments which produce taxable income;
- putting savings and investments into joint names and sharing the income;
- employing the spouse or partner in a business;
- taking the spouse or partner into partnership.

HMRC can challenge some of these if they think the transfer is not genuine – it's important to take advice to be sure that the plan will work.

LETTING A ROOM

Many people earn a little extra money by letting a room in their own home to a lodger or guest for short or long periods. There are also websites that allow homeowners to let rooms by the day or week to tourists.

If you earn money this way, you should declare any profit you make on your annual tax return. However, you can take advantage of rent-a-room relief to exempt from tax the first £4,250 you receive as rent in each tax year. Where more than one person receives the rent, each person has a tax free exemption for rent of £2,125.

The rent must be for a room in the home you also occupy, and it must be let as residential accommodation, not as an office or for storage.

CAPITAL GAINS

Most people have an annual exemption for capital gains tax (CGT) of £11,000 (£11,100 for 2015/16). This is wasted if you don't make capital gains in the tax year. You can't transfer any part of your unused exemption to a different tax year, or pass the benefit of it to another person.

Suppose you pay income tax at 40% and you make a gain of £66,000. After your annual exemption is deducted, you will pay CGT of £15,400 (28% x £55,000). If the assets you hold can be split into separate chunks, so that each sale produces a gain of less than £11,000, spreading the sales over six tax years means you will pay no CGT at all.

Portfolio managers often sell one holding of shares, and buy something else near the end of the tax year, to trigger gains and losses. The tax saving almost always outweighs transaction costs.

It's important to make sure your investment manager knows if you have realised gains on other assets. If you've used up your annual exemption elsewhere, the switching plan won't save you any tax.

INVESTING FOR THE FUTURE

When investing, there is always a trade-off between risk and return. The higher the risk you are prepared to take, the greater the return you could make, but equally there is a greater chance of losing your money.

The Government encourages certain high-risk investments in small trading companies or charities by providing income tax relief for investors in the following schemes:

- Social Investment Tax Relief (SITR): 30% relief on up to £1 million
- Enterprise Investment Scheme (EIS): 30% relief on up to £1 million
- Seed Enterprise Investment Scheme (SEIS): 50% relief on up to £100,000
- Venture Capital Trust (VCT): 30% relief on up to £200,000

These limits apply for the 2014/15 tax year. For EIS and SEIS, the amounts invested can be treated as made in the previous tax year, if the limit for the earlier year has not been reached. The SITR scheme came into effect on 6 April 2014 so investments under that scheme can't be carried back to 2013/14.

Reinvesting a gain into EIS shares or SITR shares or bonds can defer the capital gains tax on that gain. A gain reinvested in SEIS shares can halve the tax on that gain.

These various tax reliefs won't turn a bad investment into a good one, but they will make a good one better and will reduce the risk involved in investing. If you are a higher rate taxpayer who reinvests a capital gain of £100,000 in 2014/15 into SEIS shares, that £100,000 will cost you just £36,000 after income tax relief of 50% and CGT relief of 14%.

You should take advice from a qualified financial adviser on where to invest your money, as well as understanding how it will reduce your tax bill. If you are thinking of investing in one of these schemes, you may want to do so before 5 April to maximise the benefit.

FOR BUSINESS

PAYROLL CHANGES

As if RTI isn't enough to cope with, you need to be aware of changes to payroll taxes and employee benefits arriving in 2015/16.

From 6 April 2015 there will be no employer's NIC on the earnings of employees aged under 21, up to the upper earnings limit (£815 per week). You will need to keep a sharp eye on the birthdays of your younger employees, as the zero rate of employer's NIC will only apply if the employee is under 21 at the time he or she is paid.

The pay threshold above which student loan repayments must be collected through the payroll will increase to £17,335 from £16,910 on 6 April 2015. Plan your starting rate for ex-students accordingly.

Parents of children born or adopted on or after 5 April 2015 will be able to share their maternity or paternity pay and leave between them. You may need to adapt your payroll system to cope with this, as the first periods of leave could be shared as early as February 2015.

A new "taxfree" childcare scheme will start in autumn 2015. It will take the form of a savings scheme into which parents pay, and into which the Government contributes a further 20%. Only parents paying tax at less than 45% will qualify for the scheme. Your employees will need to choose between taking employer provided childcare vouchers and this new childcare scheme. We can help explain the differences.

AUTO PENSIONS

Over the next three years all employers, including individuals who employ domestic staff, will be required to enrol their eligible employees into a qualifying pension scheme. This is called pension auto-enrolment.

It will affect your business sooner or later, so you should start planning for the associated costs now. Doing nothing is not an option as there are penalties for that – including jail terms.

You will be given a 'staging date' which is your compulsory starting date for auto-enrolment. For many small businesses this will be in 2016 or 2017, but you can start the process earlier, which will help spread the costs so you don't get a big hit in 2017/18.

Every employee who meets the following criteria must be auto-enrolled:

- aged 22 or more, but under State pension age
- earning more than the basic personal allowance (£10,000 for 2014/15)
- working in the UK; and
- not already in a suitable workplace pension

This excludes very low paid workers, but those who pay at least some national insurance on their earnings will be able to opt in to the pension scheme, as will workers aged up to 75.

All employees will be able to opt out, but the employer must not encourage this, or do anything to discourage membership of the pension scheme – on pain of penalties of up to £10,000 per day for the largest employers.

The auto-enrolment process requires a good deal of record keeping – to prove you have given each employee the correct information at the right time. Again penalties apply if your compliance is not up to scratch.

Employers will be required to make contributions to the pension scheme of at least 1% of a defined range of earnings, rising to 3% by October 2018. However, this amount must be supplemented by contributions from the employee or employer, so the minimum total contribution is 8% by the same date.

The band of earnings on which this percentage contribution is based can vary according to definitions within the employee's employment contracts, and the options chosen by the employer. We can help you work out the financial cost for each option, and whether a salary sacrifice in favour of pension contributions would help bring down the total.

PLANNING TO SELL

There comes a time for every business owner when retirement becomes more attractive than carrying on. If you are reaching that point, you need to start planning for selling or passing on your business.

A sale of a successful trading company will generate a capital gain, which would normally be taxed at 28% after deduction of the annual exemption of £11,000. Entrepreneurs' relief can reduce this tax rate to 10%, but all of the following conditions must be met for at least 12 months ending with the date of the sale:

- you held at least 5% of the shares and voting rights of the company; and
- you were an employee, director or company secretary of that company or of another company in the same group.

If you step back gradually from the company, retiring from your role as director before you sell your shares, you may miss out on valuable tax relief.

If you would like to pass on your company to your employees, you can use a trust to hold the shares for the benefit of those employees. By transferring sufficient shares to the trust, that collectively provide control over the company, you will escape any capital gains tax on your disposal. However, the transfer of shares to the trust must be completed within one tax year, so it would be best to start this process at the beginning of the next tax year.

RESTRICTED INTEREST

When you borrow as an individual to invest in a business or let property, the interest you pay on the loan will be tax deductible, within limits. Interest paid on a loan used to acquire property to let, can only be deducted from rental income arising from your property letting business.

For interest due on other business loans, there is a cap on the total amount of interest plus losses that can be deducted from your other income. This is the greater of £50,000 and 25% of your income for that tax year.

If you don't get tax relief for the interest charged on a business-related loan in the year it is paid, you can't carry forward that charge to get relief in another tax year. So it's important to claim tax relief for interest paid, before other deductions for losses, which can be used in other tax years.

If your business-related loans are so high that you run into tax relief restrictions for the interest you pay, you may need to consider selling some assets to restructure your borrowings.

TIMING IS EVERYTHING

The end of the accounting period for your business is a key point for tax planning. You can save or delay tax by moving income and expenditure between accounting periods.

For instance, advancing the acquisition of assets to just within your current accounting period will mean the capital allowances associated with those assets can be claimed earlier.

Disposing of high-value assets such as property may give rise to a capital gain. Delaying the disposal into your company's next accounting period will postpone the tax payable on that gain, by up to a year.

If you have acquired a commercial property within the last two years, you should check whether the value of any fixtures within that building have been formally agreed with the building's previous owner. Without this formal agreement you could lose the right to claim capital allowances on those fixtures.

If your current year profits are looking very healthy, you may want to advance the payment of repairs, training costs, bonuses or pension contributions.

An accrued salary payment, such as a bonus voted before the year-end, is deductible for the period if it is actually paid within nine months after that year-end. However, a pension contribution must be paid within a company's accounting period, to be deductible for that period.

GOOD COMPANY?

Operating your business through a company can cost less in tax. From 1 April 2015 all companies will pay tax at 20%.

This is a much lower rate than income tax at 40% and 45% which applies to individuals. In addition, sole traders and partners pay national insurance contributions (NIC) at 9% or 2% on all the profits the business makes above a low starting threshold, whether those profits are left within the business or not.

Company owners may pay additional tax and possibly NIC, when the company's profits are paid out to them. Just how much tax and NIC are due depends on how the profits are extracted. For example, dividends are not subject to NIC, but salary and bonuses are.

Individuals can reduce the NIC they pay, by operating through a company and taking out profits as dividends, on top of a small salary. Incorporating a business is a complex decision, which should not be taken on tax grounds alone. There are more forms to file every year when running a company than an unincorporated business, but the tax savings may outweigh that.

The alternative ways of taking money out of a company can't all be used in the same circumstances. Dividends can only be paid where there are accumulated profits in the company. A salary can be paid even if the company is making a loss, but a salary over the NI threshold of £7,956 (2014/15) will carry NICs for the individual and the company, although the 'employment allowance' of up to £2,000 will reduce the company's liability to NIC (but not that of the individual).

To maximise the amount you can take out from your company and minimise the tax charges, take some expert advice before the tax year-end.

SHOULD VAT BE FLAT?

A simplified 'flat rate VAT scheme' (FRS) is available for businesses with VATable turnover of up to £150,000. You charge VAT as normal to your customers, but you don't pay all the output tax to HMRC – you keep some of it instead of claiming input tax on most expenses. That saves the bother of separating out the VAT on your costs – and gets rid of a whole lot of reasons to fall foul of the VATman.

The amount of VAT which you have to pay to HMRC ranges from 4% to 14.5% of your gross turnover, depending on the business sector in which you operate. This is the "flat rate". You choose which trade sector classification best fits your business when you apply for the scheme, then operate the flat rate attached to that sector.

If you have two different activities which fall into different trade sectors (such as catering and retailing), you must use the flat rate that applies to the activities which form the larger part of your turnover. That can make the flat rate very generous or very stingy for the smaller part of your business, and change the decision overall. For example, if you have a buy-to-let property, which counts as a business for VAT purposes. Even though you don't charge VAT to residential tenants, if you are registered for the FRS you may have to pay VAT to HMRC on your rental income.

If you are in any doubt whether the FRS is for you – whether you are currently using it or not – we'll be happy to check.

Further information can be found on our app, which can be downloaded free of charge from iTunes or Google Playstore, just search under Baxter & Co.

We are here to help so please contact:

Mark Wildi

Email: mark.wildi@baxter.co.uk

Telephone: 01689 877081