Lang Bennetts
CHARTERED ACCOUNTANTS
helping our clients prosper...

Journal

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Time to incorporate?

Changes to tax rates in April 2011 have increased the attraction for small businesses of trading as a limited company compared with self-employment, provided the owner draws income mainly as dividends.

The corporation tax rate for small companies fell by 1% (to 20%) in April, equal to the basic rate of income tax. At the same time, the main rate of national insurance for self-employed individuals increased to 9%, with 2% on profits above £42,475.

The new rates mean that self-employed people with profits of £60,000 could save over £4,400 by incorporating the business. To gain maximum benefit they would have to take a salary of up to £7,475 (the personal allowance) and draw further income as dividends. The saving results from avoiding national insurance contributions and from the lower rates of income tax on dividends compared with earnings.

More money can be saved at higher profit levels and by not drawing all the profit. Paying dividends to a spouse or partner whose income is below the higher rate tax threshold may produce further benefit.

But incorporation does not suit everyone. At low levels of profit the saving might not be worthwhile compared with the administrative costs and additional compliance needed. You might also have a problem if you change your mind. While there are tax reliefs on taking a business into a company, the opposite move can be costly.

It is also set to become more expensive to wind up a company. Normally, shareholders pay income tax of up to 42.5% on dividends. The exception is distributions in a liquidation, which are liable to capital gains tax (CGT), generally at 10%. At present, an extra statutory concession allows you to avoid the costs of a formal company liquidation and still pay CGT on distributions before the company's dissolution. However, draft legislation would impose a £4,000 limit on distributions that qualify for CGT. No date has been set for the change.

If you are looking for investment into your business, changes announced in the March 2011 Budget may make it easier to find. The rate of income tax relief for investment under the enterprise investment scheme (EIS) increased from 20% to 30% from 6 April 2011. Further changes to the EIS rules next year will mean more companies will qualify.

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This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The newsletter represents our understanding of law and HM Revenue & Customs practice as at May 2011.

Problematic expenses

The recent employee expenses report by GlobalExpense shows how expenses claims can be costly for employers.

Legitimate claims

Around £124 million in VAT was unclaimed last year because businesses did not have valid receipts for a staggering 41% of employee mileage claims.

VAT can be recovered where employees are reimbursed for fuel used on business journeys – reimbursement can either be for the actual cost or as a mileage allowance. The fuel element of a mileage allowance may be based on HM Revenue & Customs' (HMRC) advisory fuel rates or on rates set by a motoring agency such as the RAC or AA.

To recover VAT, it is necessary to obtain VAT invoices when employees purchase fuel, although these can be simplified invoices. Employees do not have to obtain an invoice for every purchase (although it is good practice to do so), as there just has to be sufficient fuel purchased to cover the amount of VAT reclaimed.

HMRC recognises that the invoice amount may not match what is being reclaimed, although an invoice cannot be dated later than the claim period. So what can employers do?

- Make sure that employees are aware of the need to obtain receipts – and that a credit or debit card receipt will often be insufficient.
- Consider providing employees with one of the many different fuel cards that are available. One VAT invoice a month will then make the recovery of VAT much easier.

Illegitimate claims

Last year businesses lost more than £300 million because of fraudulent employee expenses claims, with another £1 billion of claims not being within company policy. A few suggestions:

- Have a clear written expenses policy that is accessible to employees.
- Make sure that managers and directors who approve expenses get appropriate training and support.
- Have employees make regular expenses claims which are then promptly approved.
- Insist on a receipt to support all claims.
- Consider using expenses management software, because the cost of processing expenses can be huge compared with the amounts involved.

A change on entertainment

Following a recent judgment by the European Court of Justice, HMRC now accepts that VAT can be recovered on the cost of entertaining overseas customers. The law has been amended from 1 May, and backdated claims can be made subject to the normal four-year time limit.

Did you know that the cheque guarantee card scheme will end on 30 June this year? It will still be possible to pay by cheque and receive one as payment, although cheques written and dated after 30 June 2011 will not be guaranteed even if presented with a valid plastic card. Cheques will be completely removed from the British banking system by 31 October 2018. Cards and automated payments pushed the popularity of cheques into terminal decline: their use has dropped more than 40% since 2006. For the significant number of businesses and tradespeople still relying on cheques, it would be advisable to start assessing alternative payment options now.

Another tax amnesty in the pipeline

Tax amnesties offer a quick and cost-efficient way for the government to raise revenue. The first amnesty raised some £400 million at a cost of around £6 million.

Subsequently, there has been the New Disclosure Opportunity (NDO), the Liechtenstein Disclosure Facility (aimed at people with accounts or other assets held in Liechtenstein) and the Tax Health Plan (aimed at medical professionals).

Now we have the Plumbers Tax Safe Plan (PTSP), focused on people working in the plumbing, heating and gas installation trades. However, unlike previous initiatives, the PTSP is actually open to anybody who wishes to bring their tax affairs up to date. It is interesting that HM Revenue & Customs (HMRC) has also said that people not wanting to use the PTSP can voluntarily put their tax affairs in order and expect very similar terms to those offered by the plan, as long as they follow the guidance.

People have until 31 May to notify HMRC of an intention to use the PTSP, and disclosure must then be made by 31 August. The attraction is the usual reduction in penalties but, unlike previous tax amnesties, the penalty depends on the behaviour that led to the underpayment.

For careless behaviour, no penalty at all will be due for 2008/09 and 2009/10. The number of years of disclosure also depends on behaviour, although HMRC expects most people to have to pay for a maximum of six years.

The Liechtenstein Disclosure Facility remains available until 31 March 2015, and for some people this might be the more favourable disclosure route.

For those taxpayers who have still not disclosed their overseas income and gains, the penalties may now be substantially higher. Since 6 April, the amount of penalty has depended on the category of the country in which the income or gains arise. There is no change in respect of category 1 countries (those that automatically exchange information with the UK on savings income), but penalties are 150% of the normal amount for category 2 countries (information is exchanged but not automatically) and double for category 3 countries (no exchange of information).

Please get in touch if you wish to discuss options regarding undisclosed income. Given the possible routes available, the choice is not an easy one.

Did you know that HMRC now has its new penalty regime in place for 2010/11 self-assessment tax returns? Previously, the initial £100 late filing penalty was restricted to the amount of unpaid tax, so was reduced to nil if no tax was outstanding. This capping no longer applies, so it is now far more important to file returns on time where there is no income. Late payment penalties are similar to existing penalties, with 5% penalties due where tax is unpaid after 30 days and again after six months. But there will now be a further 5% penalty if tax is unpaid after 12 months.

Picking up the tab...

The first raft of measures restricting tax credit eligibility for higher income households has just come into effect, with further changes due next April. Changes that came into effect on 6 April include:

- The rate at which your tax credits are reduced where income exceeds £6,420 has increased from 39% to 41%.
- The £545 family element of child tax credit is withdrawn where income exceeds £40,000 rather than £50,000, and the withdrawal rate is 41% instead of 6.67%.
- The weekly maximums for childcare are unchanged, but the claimable proportion is reduced from 80% to 70%.
- The amount of income disregard has been reduced from £25,000 to £10,000. Claims are initially based on income for the previous tax year, and the disregard is the amount by which current year income can rise before a claim is revised.

Take a couple with two children, both employed full-time, income of £45,000 and weekly childcare costs of £300. For 2010/11 they would have received tax credits of £7,179, but this year they will get about £1,800 less. Their marginal tax rate is probably 73% – income tax at 20%, NIC of 12% and a 41% clawback of tax credits. In such a position, you might feel that a pay rise gives little benefit, since you will only keep 27p for each extra £1. If available, additional holiday entitlement or shorter working hours might be preferred.

Income is after deducting pension contributions and gift aid donations, so the government will pick up 61% of the tab (there is no NIC saving) if these are paid. If you are self-employed you could, for example, treat yourself to a business laptop, and save an additional 9% NIC – effectively funding just 30% of the cost yourself.

Sometimes the government might cover the full cost. The income reduction can also preserve tax credits for the following year, adding another 41% of tax saving – a total of 102% or 111%. And if you are a higher rate taxpayer the savings can be even greater.

Be warned though that this is a complex area, and unforeseen changes to your circumstances can easily ruin any tax planning. Contact us for further advice.

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Will you still need me?

The Beatles were singing about reaching 64, but since 6 April you can no longer require someone to retire when they reach 65. Many businesses already operate without a fixed retirement age, so they will have a relatively easy transition. But for others, there may be many questions:

How many employees will postpone retirement? Research suggests that nearly two-thirds of employees will postpone retirement, often because they have made insufficient pension provision.

What about pensions? Employees can claim the state pension and continue to work, or alternatively defer their pension in return for future enhanced benefits. You should consider reviewing the terms of any workplace pension scheme to support flexible later retirement.

Should I offer flexible working? Claiming the state pension and opting for flexible, part-time, working will be a popular option for many employees. However, be careful of discrimination if flexible working is offered to older workers and not to others.

What can I do about an older worker who is underperforming? The only way you can remove an underperforming worker is by using the fair dismissal procedures that apply to all employees.

Can I have an employer-justified retirement age? Yes, but only in exceptional circumstances where such an age can be objectively justified – and this may be a difficult test to pass. To date, such retirement ages have mainly been used to retire people under 65, such as where a job requires a significant level of physical fitness.

Should I change my health and safety procedures? No. In fact, many employers report that older workers tend to have fewer accidents.

Do I have to have retirement discussions with my employees? There is no requirement to do this, but you may find it helpful. Be careful not to discriminate by singling out older workers for discussions.

What about employee insurance and benefits? Group risk insured benefits such as income protection, life assurance, private medical cover and sickness insurance can cease when an employee reaches 65 (or the state pension age if higher), but not other benefits such as employee share schemes.

Where can I get more information? The Advisory, Conciliation and Arbitration Service (ACAS) and the Department of Work and Pensions websites have a range of relevant publications: visit www.acas.org.uk. and www.dwp.gov.uk/age-positive

Improved R&D tax relief for SMEs

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The generous tax relief given to small and medium size enterprises (SMEs) for research and development (R&D) costs has just got even better.

For qualifying expenditure incurred on or after 1 April 2011, the additional deduction is increased to 100%, and from 1 April 2012 it will go up to 125%. This compares with the previous relief of 75%. This means that for every £1 that an enterprise spends on R&D, a further £1 can be deducted when calculating its taxable profit or allowable loss. A loss-making company can claim a payable tax credit as an alternative.

The improved relief makes it more important than ever to claim for all possible expenditure. One difficult area is expenditure on prototypes.

Relief is generally available for the design, construction and testing of prototypes, but may be denied if the prototype is subsequently sold – it is then considered to be production expenditure, not qualifying as R&D. HM Revenue & Customs has said that it hopes constructive dialogue will resolve most disputes.

Also, following consultation on the simplification of R&D tax relief, the Government is proposing to remove the £10,000 minimum expenditure condition, and the rule limiting the repayable tax credit to the amount of PAYE and national insurance contributions paid. These changes are expected to apply from 1 April 2012.

A case of give and take

Donors to charity can now receive greater benefits as a result of a gift-aid donation of more than £10,000. In April 2011, the annual limit on the value of benefits went up from £500 to £2,500.

The benefit cannot be more than 5% of the gift, so the maximum applies to gifts of £50,000 or more. The change will allow charities to thank their larger individual and corporate donors more generously.

Less welcome, though known well ahead, was the end of the transitional gift aid relief under which charities received an additional 3p on every £1 given between 6 April 2008 and 5 April 2011. This was introduced when the basic rate of tax was reduced from 22% to 20%. Gift aid tax relief is now 25% of the donation received.

Donors will no longer be able to divert tax repayments to charity through self-assessment, starting with the 2011/12 tax return. Instead, charities will be able to make gift aid claims online from 2012/13. And from April 2013 charities that receive donations of £10 or less will be able to apply for tax relief without obtaining a gift aid declaration, though only on donations of up to £5,000 a year.

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KEY TAX DATES

Every month

1 Annual corporation tax due for companies with year ending nine months and a day previously, eg tax due 1 January 2011 for year ending 31 March 2010.

14 Quarterly instalment of corporation tax due for large companies (depending on accounting year end).

19 Pay PAYE/NIC and CIS deductions for period ending 5th of the month if not paying electronically. Submit CIS contractors' monthly return.

22 PAYE/NIC and CIS deductions paid electronically should have cleared into HMRC bank account.

30/31 Submit CT600 for year ending 12 months previously. Last day to amend CT600 for year ending 24 months previously.

File accounts with Companies House for private companies with year ending nine months earlier and for public companies with year ending six months earlier.

If the due date for payment falls on a weekend or bank holiday, payment must be made by the previous working day.

May 2011

31 Last day to issue 2010/11 P60s to employees.

Deadline for plumbers to notify HMRC of intention to disclose under the Plumbers' Tax Safe Plan (PTSP), under which the penalty on unpaid tax will normally be 10%.

July 2011

5 Final date to agree 2010/11 PAYE Settlement Agreements.

6 Last date for returns of expenses and benefits (forms P11D, P9D and P11(b)) for 2010/11 to reach HMRC. Relevant employees to receive copies of forms P11D and P9D.

Last date to submit annual returns for employee share schemes and employment-related securities for 2009/10 (forms 34, 35, 39, 40 and 42).

14 Due date for paper EC Sales List (VAT101), CT61 return and CT payment for quarter to 30 June 2011.

19 Class 1A NICs for 2010/11 due (22 if paid electronically).

31 Confirm tax credit claims for 2010/11.
Due date for second payment on account of 2010/11 income tax and Class 4 NIC.

Last day to pay 2009/10 tax to avoid second automatic 5% surcharge (unless late payment agreed with HMRC).

Last day to file 2009/10 tax return to avoid second automatic penalty up to £100.

August 2011

6 Submit employer forms P46 (car) for quarter to 5 July 2011.

31 Deadline for plumbers to make a previously notified disclosure under the PTSP and pay all liabilities.

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