Money Matters

Lang Bennetts
CHARTERED ACCOUNTANTS

helping our clients prosper...

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AUTUMN 2018

IR35 and employment status

How to get your contracts right

Inside...

Credit: iStock/Lisa-Blue

Using Enterprise Management Incentives to retain talent

Doubt over the future of Enterprise Management Incentive (EMI) share options has been lifted with the renewal of EU State Aid approval for the scheme on 15 May. EMI options can offer tax benefits to help smaller, higher-risk companies to attract and retain key employees.

HMRC advised companies to delay granting EMI options after State Aid approval lapsed on 6 April 2018. HMRC has now confirmed that options granted during the period from 7 April until receipt of State Aid approval are eligible for the tax advantages of the scheme.

Recruiting talent

Employees can buy shares at a price agreed when the options are granted under the scheme. There is no tax on the grant of an EMI option, nor on its exercise, provided the exercise price is not less than the market price when the option was granted. So, a good time to offer EMI options is during the early stages of a business when the shares generally have a low value.

Each employee may be granted EMI options worth up to £250,000 over three years and a company can grant up to £3 million of options. Only trading companies that are not controlled by another company and have assets of £30 million or less can offer EMI options.

Several trades are excluded, including property development, most financial activities, farming, leasing, and operating or managing hotels and residential care homes.

Rewarding employees

An option can be subject to individual performance targets. Employees usually exercise their options and sell their shares immediately afterwards to realise their value. Arrangements may be needed to ensure there is a market for the shares. Employees are then typically liable to capital gains tax at 10% on the increase over the exercise price.

Companies must notify HMRC within 92 days of the grant of any option and complete annual EMI returns.

There are many other conditions, so please talk to us if you would like advice on your employee-incentive scheme.

Don't end up in hot water over VAT

VAT mistakes can be very expensive, and a recent First-Tier Tribunal case shows just how easy it is to get things wrong.

The way VAT is charged on hot food was changed in 2012 when the then Chancellor, George Osborne, was forced into a U-turn over his proposed 'pasty tax'. The result is one of the oddities of the VAT system, where VAT is only charged on takeaway food if it is hot when sold.

The tribunal case involved the sale at a market of rice, wraps and curries. Despite the food being allowed to cool to around 20°C after cooking, it was kept at an average temperature of 56°C for sale. This was considerably higher than the ambient air temperature of the premises and so, not surprisingly, the judge sided with HMRC. The taxpayer ended up with a VAT bill for £114,122 covering a four-year period.

Retrospective assessments

HMRC can normally go back four years when assessing VAT errors, but they can go back further if there is dishonesty involved. In addition, a penalty may be applied depending on a taxpayer's conduct. There is no penalty if the taxpayer has taken reasonable care, but there can be a 30% penalty for carelessness. This can be reduced to zero if unprompted disclosure is made, and down to 15% with prompted disclosure.

The way VAT is charged on sales can be a source of confusion, because the system contains many peculiarities. For example, peanuts in shells are zero rated, while shelled salted peanuts are standard rated. Physical books are zero rated, but ebooks are standard rated. Services are affected as well – for example, a tutor's services are zero rated unless the tutor has incorporated, in which case the tuition becomes standard rated.

With such heavy penalties and a complicated system to untangle, it is essential to understand and charge your VAT correctly.

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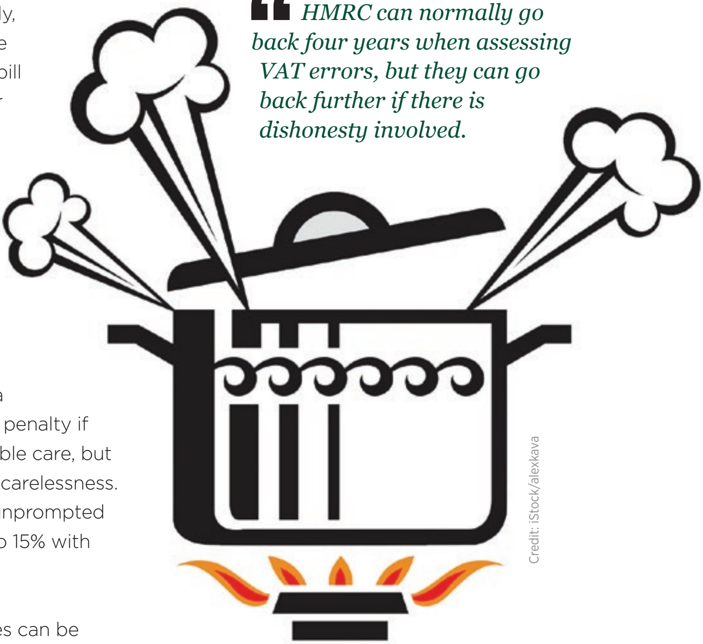

Credit: iStock/alexkava

Defining your employment status for IR35

The way HMRC applies the off-payroll working rules has been successfully challenged in a tax tribunal appeal, with implications for contractors and the so-called IR35 regime generally.

The tribunal decision came as HMRC launched a consultation on tackling non-compliance with the IR35 rules in the private sector.

The tribunal ruled in favour of an IT contractor who provided his services to the Department for Work and Pensions (DWP) during 2012/13 through his company, and via a recruitment agency. HMRC decided the contractor's terms of engagement equated to employment under the IR35 rules and deducted over £26,000 in income tax and national insurance contributions from his deemed earnings.

Assessing employment status

In reaching her decision, the judge emphasised that she had looked at the overall picture and made a qualitative assessment of the features of this case. The ruling gave some useful insights into the factors that determine employment status.

- **Mutuality of obligations** HMRC argued that the DWP had an obligation to provide work and the contractor had an obligation to perform it under the hypothetical contract between them. The judge considered this was no more than what exists in every situation where a person works for payment. The contractor also worked under a succession of short contracts and the DWP was not obliged to offer further work.

- **Substitution** The contractor was allowed to send a substitute if the DWP agreed,

according to the contract with the recruitment consultant. However, the question had never arisen and the contractor admitted he always sought such a clause because it was characteristic of self-employment. Nevertheless, the substitution right was real and it weighed against employment status.

- **Control** The contractor had considerable freedom to decide how to meet the needs of the project and the timescale for the work. He had no set hours and worked with minimum supervision, but gave frequent feedback to a DWP manager. These meetings, on which HMRC's case had relied, were not indicative of control over an employee but of the DWP ensuring that its needs were met, as any independent contractor would require.

Private sector changes

Since April 2017, public sector clients (or the agency where there is one) have been responsible for deciding an individual's IR35 status and deducting tax and NICs where necessary.

HMRC estimated compliance with the off-payroll working rules at 10%, but the public sector rules have increased this. An HMRC consultation running until 10 August 2018 sets out proposals for increasing compliance in the private sector. One proposal was to extend the public sector rules to the private sector, but HMRC has also aired other possibilities. For example, the client could be required to ask the personal service company to provide a completed determination under HMRC's 'check employment status for tax' (CEST) service.

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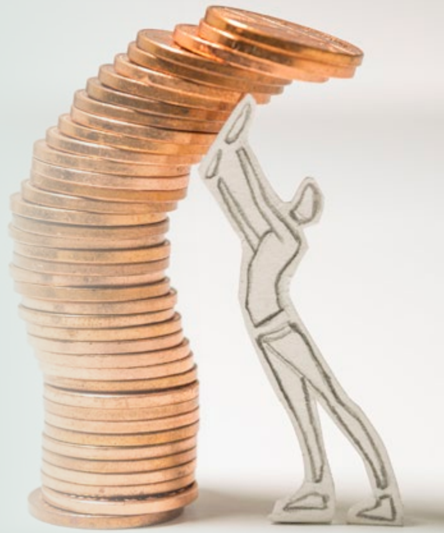
HMRC says CEST gives an answer in 85% of cases and that the outcome is self-employment in 60% of these. However, CEST has been heavily criticised and does not test for mutuality of obligations at all. Given the importance of mutuality of obligations in this case, CEST may not be the best solution.

If you would like help dealing with the IR35 rules, please let us know.

Credit: iStock PeopleImages

Fluctuating incomes impact on Universal Credit


Credit: iStock/woolzian

Inconsistencies in the Universal Credit rules could cost self-employed claimants hundreds of pounds a year.

The Universal Credit rules will cause issues for people with fluctuating earnings in particular. For example, self-employed claimants with irregular income could receive less than employees earning the same amount from a regular monthly salary.

Unlike tax credits, which essentially use the income tax rules for establishing the amount of self-employed earnings, Universal Credit:

- calculates earnings on a monthly basis, without any averaging;
- uses actual receipts and payments to calculate earnings, even though earnings for tax purposes may be calculated on an accruals basis; and
- applies an assumed level of earnings – the minimum income floor (MIF) – after a start-up period of 12 months.

The MIF is the core of the problem for self-employed people with fluctuating earnings. Very broadly, the MIF assumes that a self-employed person will earn the equivalent of the national minimum wage. Deductions are made for income tax and NICs. Actual earnings are used where they are higher than the MIF, but Universal Credit does not make up the shortfall if monthly earnings are lower than the MIF.

EXAMPLE

Simone's MIF has been set at £1,000. During 2018, she earns £1,400 a month for nine months, but only £300 during each of the other three months. Her Universal Credit payments will be based on earnings of £1,400 for nine months and £1,000 for three months. This is £2,100 more than Simone's actual earnings for the year. The earnings taper reduces the amount of Universal Credit by 63p per every £1 earned over a set amount, so higher earnings could potentially cost her a significant amount in Universal Credit.

The MIF is intended to weed out unviable businesses. Anyone considering moving from employment into self-employment should be aware of how it might impact on their claim for Universal Credit.

The increasing burden of property ownership

Some changes are about to take place that will affect how property owners pay tax. They will impact on both UK resident and non-resident individuals who own property personally or through a company.

Payment window for gains

From April 2020, you will be required to make a payment on account of capital gains tax (CGT) when you dispose of a residential property situated in the UK or overseas. Payment will be due within 30 days of completion of the disposal.

Payments on account will not be due where full private residence relief is available, so the change will mainly affect those disposing of a second home or a rental property.

With the 30-day payment window, it will be essential to have all the information necessary for calculating the gain readily to hand. This can be a particular issue where the property has been enhanced, especially if you carried out much of the work yourself.

Non-residents owners of UK property

If you are non-resident in the UK, you are already taxed on gains made when disposing of UK residential property. From April 2019, this liability will be extended to:

- **Non-residential property** Property values will be rebased to April 2019, so that only subsequent gains will be taxed. However, the original property cost can be used if beneficial – such as where rebasing results in a gain where there is an overall loss. Unlike the treatment of residential property gains, there will be no option to time apportion a gain over the period of ownership
- **Indirect disposals** For example, the disposal of shares in 'property rich' companies – where at least 75% of a company's asset value is represented by UK property.

If the changes affect you, this is a good time to carry out a review of current holding structures and any plans for future acquisitions/disposals. At the very least, you need to arrange for April 2019 property valuations.

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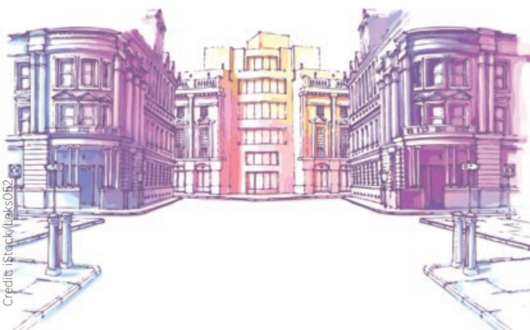

Credit: iStock/Leks052

The tax experts

Let's face it, the very mention of the word 'tax' either gets us groaning or, worse still, burying our heads in the sand. Our clients, on the other hand, have no reason to panic. The expertise of our highly qualified tax team has legitimately reduced collective tax bills in the last two years by millions.

"Ours is an interesting, very satisfying job because we can genuinely make such a difference," said Tax Director Simon Prior. "Our role is to help businesses grow by providing tax and business advice that looks way beyond the routine and obvious. It's a complex area but one that's vital for growth and commercial success."

These are just some of our tax team's success stories:

- **Research and development (R&D).** In two years, they've helped corporate clients save more than £1m in tax by alerting them to their tax credit eligibility. They've also worked as consultants for other firms of accountants drafting reports and R&D tax calculations.

- **Inheritance tax (IHT).** When reviewing a client's will recently, a simple re-allocation of

assets to various beneficiaries resulted in a saving of £300,000.

- **Capital allowances in property.** A relief that businesses in the leisure and tourism industry may not know about is their eligibility for capital allowances on fixtures within the buildings they own. One client saved around £250,000 last year.

- **Business disposals.** There are various reliefs available to those selling a business. One of our clients significantly reduced their end tax bill by claiming them.

- **HMRC enquiries.** Having taken over the case from their previous accountants, a new client's unpaid tax liability was reduced by more than 30% and the threat of bankruptcy removed.

- **Stamp duty land tax (SDLT).** A client was advised to apply for a relief that resulted in a saving of more than £9000.

Please get in touch to find out more.

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