client BRIEFING

Farries, Kirk & McVean

Chartered Accountants

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In this issue:

Summer 2015 Budget surprises

Employee benefits: a win-win for all

PAYE and late reporting pitfalls

Financing start ups with SEIS

Auto-enrolment kicks in

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Summer 2015 Budget surprises

Mr Osborne's seventh Budget – and his first free of coalition constraints – contained plenty of surprises.

The Budget immediately after an election is often the most interesting – and taxing. In its post Budget analysis, the well-respected Institute for Fiscal Studies (IFS) noted that "post-election budgets tend to raise at least £5bn in tax – and this one expects to bring in a little more than that".

Dividend taxation

One of the most significant changes and revenue-raisers for the Exchequer was the reform of dividend taxation from 2016/17. The 10% (non-reclaimable) dividend tax credit will disappear, replaced by a new £5,000 dividend allowance, which will be separate from the personal allowance. Once that allowance is exceeded, the new dividend tax rates will apply: 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.

While 85% of those who receive dividends will see no change or will be better off, if you are a company owner who draws dividends instead of a salary, you could be considerably worse off. Now is the time to consider drawing a dividend, something the Treasury expects many directors to do before next April.

Buy-to-let

Residential buy-to-let investors were also targeted for more tax. From April 2016, the 10% wear and tear allowance will be replaced with a new relief based on the actual costs incurred in replacing furniture. Then, over a period of four years from 2017/18, the rate of tax relief on finance costs (primarily interest) will be phased down to basic rate for individual investors. The end result will be to expose more rent to income tax. However, there was one small piece of good news on the residential letting front: after an 18-year freeze, rent-a-room relief will rise from the current £4,250 to £7,500 from 2016/17.

Inheritance tax

Unfortunately the Chancellor also extended another freeze for a further three years. The inheritance tax nil rate band will now remain at £325,000 until April 2021. But there will be a new transferable main residence nil rate band, initially £100,000 in 2017/18, rising by £25,000 a year to £175,000 in 2020/21. The net effect of this will be that from April 2020 a couple with an estate of up to £2m will be entitled to nil rate bands totaling £1m (2 X £325,0000 + 2 X £175,000), provided that they have (or, in most cases, have had) property worth at least

£350,000 which is passed to direct descendants. Above £2m, the new band will be subject to a 50% taper.

Pensions

The new IHT allowance is being funded by yet another cut of pension allowances: from 2016/17 the annual allowance will be reduced if your total income exceeds £110,000 and your total income plus all pension contributions exceeds £150,000. Once again a 50% taper applies, but this time with a minimum – a £10,000 annual allowance once income plus contributions reach £210,000. The lifetime allowance – the maximum tax-efficient value of pension benefits – will also be cut by 20% to £1m from 6 April 2016 and a fourth set of transitional reliefs will be introduced. Longer term, the whole issue of pension tax relief could disappear, as the Treasury issued a consultation paper alongside the Budget on "strengthening the incentive to save". Among other ideas in the paper was the replacement of tax relief on contributions with a government top-up.

The many changes in this second Budget of 2015 mean tax strategies will need careful review well before the end of the tax year. We are here to help.

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Employee benefits: a win-win for all

If you provide your employees with a range of social benefits focused on childcare, eldercare and health care, then you should expect some improvements in productivity in return.

You might decide to make use of the expertise of a specialist benefits provider; doing so should lighten your administrative burden and give your employees access to a wider choice of benefits.

You can, of course, help employees with both childcare and eldercare by offering flexible working and working from home, and neither will result in any tax cost. You could even pay a tax-free amount of up to £4 a week towards the additional costs that an employee incurs as a result of working at home.

Employers normally provide employees with financial assistance with childcare through the use of tax-free childcare vouchers, with each parent able to receive up to £2,916 annually. Childcare vouchers are usually offered under a salary sacrifice arrangement, but that's not essential. With salary sacrifice, an employee gives up a portion of taxable salary in return for tax-free vouchers, saving both tax and NICs.

The childcare voucher scheme will no longer be available to new entrants from early 2017, so now could be a good time to be bringing people on board. You can also provide employees with tax-free nursery or child-minding facilities, but any other childcare support will be taxed. Unfortunately, the same applies to any eldercare support given to employees caring for parents.

Employees can make use of a company gym without any tax implications whether it's provided free or at a subsidised price. You can also provide healthy food in a company canteen. However, if you pay for a fitness club membership or provide a dining card, there are likely to be tax implications. Cycling to work can be encouraged by providing employees with tax-free bicycles and safety equipment, and an employee can be given the opportunity to purchase the bicycle at a fair market value following the end of the loan period.

You can provide tax-free annual health checks, health counselling and eye tests (where an employee is required to use a computer), but medical insurance and medical treatment are normally taxable. There is, however, an annual exemption of up to £500 if you pay for medical treatment to help an employee return to work following sickness or injury.

Be warned that tax-free benefits are generally subject to strict conditions and often have to be available to your entire workforce for the tax-free status to apply. Please get in touch if you want to discuss any aspect of your current benefits package, or to find out more about upcoming changes.

PAYE and late reporting pitfalls

Despite a softening of HM Revenue & Customs's (HMRC's) attitude towards PAYE penalties, running your own payroll can still be something of a minefield unless you are well organised. Even if we take care of your payroll, we are still reliant on you to provide us with timely information.

Late submission penalties are a relatively new phenomenon, and this is the first tax year that they have been fully in place. Penalties apply if a full payment submission (FPS) is made late, although there is some built-in leniency.

For each submission, there is currently a three-day grace period before HMRC will impose a penalty, and the first default each tax year is penalty-free. And there is no need to be particularly concerned if your payroll is weekly, because the penalty system is applied on a monthly basis – which means just one penalty even if more than one FPS is late during any particular tax month. The potential penalty depends on how many employees you have:

Number of employees	Monthly penalty
1 to 9	£100
10 to 49	£200
50 to 249	£300
250 or more	£400

HMRC can also charge an additional tax-based penalty if an FPS is more than three months late.

The penalty system is of course entirely automated, and HMRC will typically expect to receive 12 FPSs from you each year. Therefore, it is important to submit an employer payment summary (EPS) for any month in which no employees are paid. But you have a little more leeway here because an EPS is not due until the 19th of the following month.

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HMRC sends out penalty notices quarterly. If you think a penalty is incorrect then there are a number of grounds on which to base an appeal. Maybe you were late because of an IT problem, a natural disaster, ill health or a bereavement, or possibly you no longer have any employees.

For smaller companies with just salaried directors (or even employees), there are some ways of minimising the risk of incurring a late submission penalty. The easiest option is to just file several FPSs in advance, maybe three months at a time if this ties in with quarterly payments. It is always possible to file a corrected FPS should, for example, a director or employee unexpectedly leave.

Financing start ups with SEIS

Raising finance for a start up company can be difficult at the best of times, but it can be somewhat easier if investors are protected should your company do less well than expected.

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This is where the generous tax breaks offered under the seed enterprise investment scheme (SEIS) can come into play. The SEIS income tax reliefs alone mean that an additional rate taxpayer is risking just £2,750 of every £10,000 invested if the worst happens and your company's shares become worthless. Investors will benefit by £5,000 if the shares do not grow in value, and if your company prospers the SEIS investment can be sold tax-free.

HM Revenue & Customs's (HMRC's) small companies enterprise centre (SCEC) will decide if your company and share issue qualify, and we recommend companies to get advance assurance of qualification. Not surprisingly, the qualifying conditions for the company are quite stringent, including:

- If the company is already trading, the trade must have been carried on for less than two years.
- Various 'safe' trades, such as property development or running a hotel, nursing home or residential care home are not permitted.
- You must have fewer than 25 employees.
- Gross assets cannot exceed £200,000.
- The company has to be unquoted, although listing on the AIM or ISDX markets is permitted.
- There cannot have been any previous investment under the enterprise investment scheme or from a venture capital trust.

The total amount that your company can raise under the SEIS is limited to £150,000, and the shares issued must be full-risk ordinary shares and fully paid up.

Your investors won't be able to claim any tax reliefs until you receive SCEC authorisation. However, you can't apply for this until the company has either been trading for four months or at least 70% of the money raised by the share issue has been spent. Once authorised, the SCEC will issue the company with a certificate as well as tax relief claim forms for you to forward to your investors.

If your company has already started trading, you need to start planning well in advance of the two-year deadline. It could take up to two months to obtain advance assurance from the SCEC, and you will then need to find investors – they may not be interested until you have SCEC assurance.

Auto-enrolment kicks in

If you employ a nanny, cleaner or carer, you may soon have to set up and pay into a pension scheme for them. The phasing in of pension automatic enrolment has now reached its final phase and, by April 2017, almost every employer will have to take action.

Auto-enrolment applies to employees aged between 22 and state pension age who are paid over £192 gross a week (£833 a month). Although employees can opt out, most don't. Employees who are not within auto-enrolment, for example those aged under 22, can opt into a workplace pension and the employer must then contribute on their behalf. Initially, employers and employees each contribute just 1% of the employee's earnings between £5,824 and £42,385 a year in 2015/16. By 2018 this contribution level will rise to 4% for employees and 3% for the employer, with a further 1% coming from tax relief.

Every employer has a 'staging date' when auto-enrolment starts for them. The dates have been allocated at random for employers with fewer than 30 staff, so the first thing you must do is find out when your staging date falls, because will need to have your arrangements in place by then. The dates are available from the Pensions Regulator – you will need your PAYE reference.

Well before your staging date you should make sure your staff records are correct, in particular their date of birth, national insurance number and contact details. You will then be in a position to assess whether they fall within auto-enrolment or will be able to opt in. Payroll software will simplify this process, so make sure your software (or payroll agency) fully supports auto-enrolment.

An important task is to select a pension scheme. You can use the government's National Employment Savings Trust (NEST), or choose another provider. Within six weeks following your staging date you must write to each employee to tell them how automatic enrolment applies to them and what their rights are. The Pensions Regulator provides letter templates to ensure you comply with the legal requirements.

Within five months of your staging date you must complete a declaration of compliance. That is not the end, however. You might take on a new employee, or an existing employee may move into or out of auto-enrolment as a result of changes in age or salary. We will be happy to advise you on getting ready for auto-enrolment and comply with your other obligations as an employer.

Pensions freedom: go steady

The new pensions freedom rules are very useful for people in retirement – but there are dangers if you draw funds without thinking through the possible tax consequences.

Since 6 April 2015, it has been possible for you to draw a large lump sum from your pension scheme to spend on whatever you like, providing you are aged 55 or over. You could pay off your debts, carry out home improvements, or you may wish to help your children or grandchildren through school or university or fund a deposit for their first home.

But beware, you might receive a lot less from your pension than you expect. Many people think all pension lump sum payments are tax free. Some are, but many are not and you may find the tax deduction is far bigger than you think.

There are two ways in which you can flexibly draw from your pension fund. Flexi-access drawdown lets you take a tax-free lump sum, usually 25% of your fund, and leave the rest invested. Withdrawals from the remaining 75% are then taxable in full. If instead payments are made under the uncrystallised funds pension lump sum (UFPLS) rules, each payment consists of 25% tax-free cash with the rest taxable.

There are other differences between flexi-access drawdown and UFPLS. You can, however, use flexi-access drawdown to replicate the UFPLS way of drawing funds if you wish.

The way in which tax is deducted from a taxable withdrawal presents a particular difficulty. When a taxable payment is made from the fund, the tax is calculated under pay as you earn (PAYE) using an emergency 'month 1' tax code;.This assumes the payment will be the first of a series of monthly payments. So only one-twelfth of the personal allowance and each tax band is set against the payment, resulting in more of it being taxable at higher rates.

For example, if you take a payment of £40,000 under UFPLS, £30,000 will be taxable and tax of £11,947 will be deducted. But if that payment is your only income in 2015/16, your correct tax liability would be £3,880. To reclaim the overpayment of £8,067, you have to apply to HM Revenue and Customs, leaving you out of pocket while it is processed. If you are planning to make pension withdrawals, it is essential to take professional advice both on the choice of arrangement and on your potential immediate and final tax liabilities.

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Farries, Kirk & McVean
Dumfries Enterprise Park
Heathhall
Dumfries DG1 3SJ
Tel 01387 252127
Fax 01387 250501
Email info@fkmcv.co.uk

Also at
12 Murray Street, Annan
Tel 01461 202489
38 Drumlanrig Street, Thornhill
Tel 01848 330850
87 High Street, Lockerbie
Tel 01576 203099
73 High Street, Dalbeattie
Tel 01556 611544

Partners
R W Mitchell BA CA
C Paterson BCom CA
G M McGill BA CA
R B Palmer BA CA

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