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CHARTERED ACCOUNTANTS

money matters

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UP TO DATE DEVELOPMENTS IN TAX AND BUSINESS PLANNING

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Salary sacrifice: change down the road

The use of a salary sacrifice arrangement can be a win-win for both employer and employee. But the government is proposing new restrictions.

The basic idea is that an employee gives up a portion of their salary in return for a non-cash benefit. This works particularly well if the benefit provided is wholly or partially exempt from tax and National Insurance contributions (NICs). Popular arrangements currently involve employer pension contributions, childcare vouchers, cycle to work schemes, low emission company cars, mobile telephones and workplace parking spaces.

For example an employee with a salary of £35,000 gives up £2,000 of this in return for the employer making £2,000 of pension contributions on their behalf. The employee's income tax is reduced by £400, and both the employee and the employer save NICs – £240 for the employee and £276 for the employer. The saving is at an employee's marginal tax rate, so the above employee – as a basic rate taxpayer – benefited by an overall 32% saving, a higher rate taxpayer would save 42% and an additional rate taxpayer would save 47%.

Salary sacrifice can be especially beneficial where employees find themselves at just above one of the fault lines in the tax system, such as the 60% marginal income tax rate applicable when the personal allowance is tapered away. However, lower earnings can reduce the level of an occupational pension, affect entitlement to earnings-related state benefits, impact on mortgage applications and reduce any life cover based on salary.

Of course, many benefits are not tax-free, so sacrificing salary for the likes of private medical insurance, home technology or a wine plan only saves employee NICs – which are just 2% where earnings exceed £43,000. The main advantage here comes from the employer being able to negotiate bulk discounts.

New rules from April 2017

The government has become concerned about the increased popularity of salary sacrifice arrangements. Apart from the cost to the Exchequer, there is the matter of the uneven playing field which has developed. Lower-paid employees are often excluded because salary sacrifice cannot reduce cash earnings to below the rate of the national living wage or national minimum wage. Also, smaller employers are unlikely to be able to offer the same range of benefits as larger employers.

The government is therefore proposing to restrict the use of salary sacrifice arrangements by removing most of the tax and NIC advantages. The change will be implemented from 6 April 2017, although the following benefits will NOT be affected:

- Employer pension contributions
- Employer-provided pensions advice
- Employer-supported childcare (including childcare vouchers)
- Cycles and cyclists' safety equipment provided under the cycle to work scheme

Where any other type of exempt benefit is provided in conjunction with salary sacrifice, the exemption will no longer apply. Income tax and employer's class 1A NIC will then be payable on the greater of the salary sacrificed and the value of the benefit calculated using normal valuation rules.

For example, a salary of £600 is sacrificed for workplace parking. The taxable benefit will be £600. For non-exempt benefits, the change is less drastic, but it does mean that tax and class 1A NIC will be due on the amount of salary sacrificed if this turns out to be higher than the normal benefit valuation. So there will be no advantage from company bulk discounts, but still an employee NIC saving.

Now is a good time to review the tax effectiveness of current or proposed arrangements. Exempt benefits offered outside of a salary sacrifice arrangement will be unaffected by the change. We, as always, are happy to help.

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Making tax digital – still confused?

Most businesses, self-employed people and landlords will soon have to manage their tax affairs digitally and update HM Revenue & Customs (HMRC) at least quarterly.

The radical reform will spell an end to the annual tax return by 2020 and the government is promoting it as a simplification of the tax system. But it has caused some confusion and concern among those affected.

Many of the details of how Making Tax Digital (MTD) will work have yet to be decided and have been subject to consultation. So far HMRC has announced two exemptions from MTD and these are: all unincorporated businesses and landlords with turnover under £10,000, and anyone who is unable to use digital tools. MTD for income tax and national insurance will start in April 2018.

However, to give smaller businesses more time to prepare, the government has postponed its introduction until 2019 for small unincorporated businesses with income between £10,000 and an upper threshold to be determined.

Three-line accounting

One issue still subject to consultation is the continuation of 'three-line accounting', whereby businesses below the VAT registration threshold currently only have to report income, total expenses and profit. The facility may be removed or restricted. However, there may be an extension of the cash basis for income tax. HMRC has no plans to offer its own free software, but wants software developers to provide free and low cost software for businesses with the most straightforward affairs.

HMRC has confirmed that quarterly updates need only be summary data. Partnerships may benefit because quarterly updates by the partnership could feed directly into each partner's digital tax account.

MTD will also enable businesses and landlords to make voluntary tax payments towards their liabilities. Voluntary 'pay-as-you-go' (PAYG) sums would sit as credits on a taxpayer's digital tax account and be allocated against tax, including VAT, liabilities as they become due.

For taxpayers who do not have business or letting income, MTD may remove the need to complete a self-assessment tax return, because HMRC hopes to receive information directly from third parties about a greater range of income types, such as dividends.

Much of the detail remains uncertain, but as all gradually becomes clear we will be here to help you understand and comply with the new obligations.

Capital gains tax: reliefs and timing

It is important to make the most of the various capital gains tax (CGT) reliefs availabe to taxpayers.

Property

Principal private residence relief (PRR) exempts one home from CGT provided it is used as your main residence. There are various planning possibilities should you own additional properties. If you live in two (or more) properties, then an election can be made as to which one is treated as your main residence. If PRR is available, then the final 18 months of ownership are always exempt.

The decision of which property to elect as your main residence will depend on the amounts of potential gain, lengths of ownership and disposal plans. However, you only have two years after acquiring an additional residence to make the election. If a let property qualifies at some point for PRR, then a further letting relief (of up to £40,000) is available. It might therefore be worthwhile moving into a let property before its disposal.

Disposal of a business

A disposal of a business qualifying for entrepreneurs' relief benefits from a 10% tax rate.

There is a general one-year qualifying condition, so it might be worth delaying a disposal if not currently met. However, where a sole trade or partnership is being disposed of, it is only the business itself which must be run for one year.

Although the whole business need not be disposed of, it is necessary to dispose of a clearly identifiable part. If a shareholding is disposed of, the company must be a trading company for the preceding year. If this test is not met because surplus funds have been invested in property or other investments, it might be possible to rectify the situation before disposal.

Replacing business assets

Gains on the disposal of certain business assets can be deferred (rolled over) if new qualifying assets are bought. This must be done during the four-year period running from one year before the disposal to three years after. The most common qualifying assets are land and buildings, fixed plant and machinery and goodwill (disposals by individuals only). So plan carefully – it might be worthwhile bringing forward a disposal to match an acquisition within the previous year if no more purchases are planned.

Be warned that CGT is far more complicated than this basic outline, so please contact us for more detailed advice.

Changes to non-domicile status

The government has revealed more details of how the proposed changes to non-domicile status will work.

A new consultation document also outlines how inheritance tax (IHT) will be charged on UK property held through an offshore structure and asks for ideas on how business investment relief could be made more attractive.

From 6 April 2017, UK residents will not be able to retain non-domicile status indefinitely. Instead individuals will be treated as domiciled in the UK for income tax, capital gains tax (CGT) and IHT after they have been UK resident for at least 15 of the previous 20 years – the '15/20 rule'. This will include years during childhood. They will lose their deemed domicile status if they are non-resident for at least six consecutive tax years for income tax and CGT. However, the present four-year period will be retained for IHT.

Individuals will also be deemed domiciled if they were born in the UK with a UK domicile of origin and later return to the UK – returning non-doms. However, their worldwide assets will not become subject to IHT unless they were UK resident in one of the two preceding tax years. This means people who return to the UK for a short time will not have to rewrite their wills.

Individuals who become deemed domiciled under the 15/20 rule on 6 April 2017 can opt to rebase assets to their market value on 5 April 2017 for CGT purposes, subject to conditions. They will also have one year from April 2017 to rearrange mixed offshore income and/or capital gains funds to enable non-taxable capital to be remitted free of tax. Residential properties owned indirectly through an offshore company or partnership will be brought within the charge to IHT. Relevant debts, such as a mortgage, will be deductible.

Since April 2012, individuals who use the remittance basis have been able to bring overseas income and gains into the UK without a tax charge if they do so to make a commercial investment. The consultation seeks views on how business investment relief can be expanded to increase take-up, while ensuring it cannot be used for tax avoidance.

If you stand to be treated as deemed domiciled from April 2017, or will be returning to the UK after that date, please discuss

An update on savings and ISAs

With interest rates on offer to savers continuing at record lows, the government has been busy introducing various tax incentives to encourage saving. However, these don't always quite work out as intended.

This tax year, a tax-free personal savings allowance was introduced. For basic rate taxpayers, this exempts up to £1,000 of savings income, with a £500 limit for higher rate taxpayers. Many savers are now using bank current accounts that offer rewards as a way of achieving better returns. For example, one popular current account pays a £5 monthly reward if £750 or more is paid in each month and at least two different direct debits are paid out.

However, HM Revenue & Customs has recently confirmed that these rewards are ineligible for the personal savings allowance because they are not classed as savings income.

The Help-to-Buy ISA

Then there is the Help-to-Buy ISA which became available from 1 December 2015. The government tops up an investor's Help-to-Buy ISA savings with a 25% bonus (up to a maximum of £3,000) when the savings are used to buy a first home.

The scheme has recently come in for criticism because the bonus is not paid until completion of the property purchase. It cannot be used for the deposit due at exchange of contracts.

The Treasury has now announced that funds in a Help-to-Buy ISA can be transferred into a new Lifetime ISA (LISA) from April 2017. LISAs benefit from a government bonus which will be available to pay deposits. However, money saved in a LISA cannot be used for a year after the account is opened.

The Innovative Finance ISA

As a result of further relaxation of the ISA rules, from 1 November it will be possible to hold certain company and charity debentures and bonds made available through a crowdfunding offer within an Innovative Finance ISA.

The Innovative Finance ISA itself was only introduced this April in order to bring peer-to-peer lending within the ISA net. The returns on peer-to-peer lending can be up to 7%, but this higher return comes with a risk warning.

Although peer-to-peer savings firms have introduced various ways of mitigating the impact of bad debts, any losses are not covered under the £75,000 per person Financial Services Compensation Scheme. Furthermore, peer-to-peer lending has so far never really been tested by a financial crisis – so think carefully about Brexit here.

As always, we are able to provide you advice so don't hesitate to get in touch.

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The benefits of charitable giving

Saving tax may not be the main concern when giving to charity, but you might as well benefit if you can.

Gift aid: Any donations should be made under a gift aid declaration. Although there is no tax relief as such for basic rate taxpayers, a donation of £100 will be worth £125 to the charity. Higher and additional rate taxpayers save tax, so for an additional rate taxpayer, the net cost of a £100 gift is £55. If you are in the position that your personal allowance is tapered away (income between £100,000 and £122,000), then the net cost drops to just £40. Donations can also help preserve entitlement to tax credits and limit the impact of the child benefit tax charge. Consider which family member will benefit the most from making donations – it will not necessarily be the highest earner.

Assets: Gifts of certain land, property and shares will save you both income tax and capital gains tax (CGT). The value of the donation is deducted from taxable income, saving tax at your marginal rate – which could be as high as 60%. There is also relief from CGT, which could be as high as 28% for residential property. Obviously, the amount of relief depends on how much the asset has appreciated in value. Sales at less than market value also qualify for relief, so you can realise some money as well as save tax.

Inheritance tax (IHT): Any donations you make in your will reduce the IHT payable on your estate. So if you leave more than 10% of your estate to charity, then the rate of IHT on the remainder is reduced from 40% to 36%. The actual amount required might be much lower than you think. For example, for an estate valued at £800,000 with 50% left to a spouse, donations of £7,500 are required.

You can avoid the need to continually revise your will with a clause worded so that a specific legacy to charity will always meet the 10% test.

Be warned that the detailed rules can be quite complicated, so please contact us for advice.

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