COMPASS ACCOUNTANTS

TAX ANGLES FOR PROACTIVE PLANNING

Newsletter - August 2018

In this month's edition…

Paying family members

Many small businesses, whether incorporated or not, pay family members for working for the business. However, as a recent case shows, it is easy to make mistakes which can prove costly.

The case in question, *Nicholson v HMRC* (TC06293), concerned the payment of wages by a sole trader to his son while at university. Mr Nicholson was a central heating salesman, who was trying to build up an internet business. His son had worked for his father for many years, and when he went away to university, he continued to work for his father, 'promoting the business through internet and leaflet distribution and computer work'.

He was paid at the rate of £10 per hour for 15 hours' work a week. However, there was no evidence to support the payment of wages on this basis and payments were made partly in cash and partly through the provision of goods – Mr Nicholson bought his son food and drink to help him whilst at university and claimed a deduction in his business accounts for this as 'wages'.

The First Tier Tax Tribunal disallowed a deduction for the wages paid to Mr Nicholson's son. Although there was no dispute that his son worked in the business, there was no evidence to back up the claim that the payments had been made wholly and exclusively for the purposes of the trade. It was not possible to reconcile what had been paid as wages to the bank statements, and without contemporaneous records to support the payments,

HMRC were unable to accept the sums claimed were 'wages' incurred as a business expense. The payments had a dual purpose – the underlying motive was the 'personal and private' motive of supporting his son while at university.

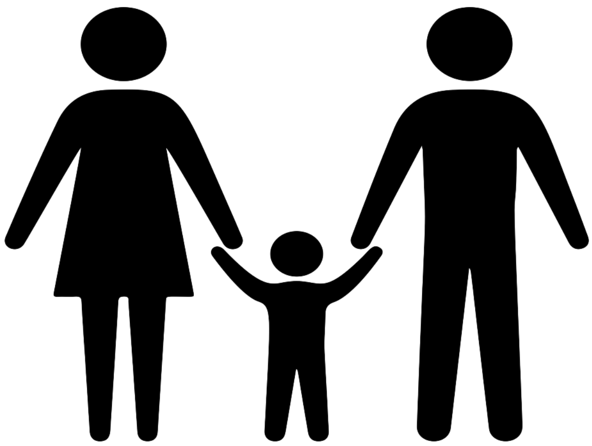
Avoiding the pitfalls

Had Mr Nicholson taken a different approach, he would have been able to claim a deduction for the wages paid to his son.

The judge noted that had payment been made on a time recorded basis or using some other methodology to calculate the amount payable, and had an accurate record been maintained of the hours worked and the amount paid, it is unlikely that the deduction would have been denied. If instead Mr Nicholson had made payments to his son's bank account at the rate of £10 per hour for 15 hours' work a week, leaving his son to buy food and drink etc. from the money he had earned working for his Dad, the outcome would have been different.

The bank statements would provide evidence of what had been paid and this could be linked to the record of hours worked. Maintaining the link is key.

When paying family members, it is also important that the amount paid is reasonable in relation to the work done. The acid test is whether payment would be made to a person who was not a family member at the same rate. A deduction may also be denied if the wages paid are excessive.



Quote of the month…

"Yesterday is gone. Tomorrow has not come yet. We have only today. Let us begin."

- Mother Teresa

Tax-free income from renting out your drive

Your drive may not normally warrant a lot of attention— however, it may have the potential to generate a tax-free income. Parking near to town centres and stations is always limited, and parking is always needed for events. Owning a drive, field or land that can be utilised for parking provides the opportunity to earn some money; even better, it may be tax-free.

£1,000 property allowance
Two new allowances – each set at £1,000 – were introduced from 6 April 2017, one for trading income and one for property income. The allowances are available in addition to the personal allowance.

As far as the property allowance is concerned, if income from property is £1,000 or less in the tax year, there is no tax to pay and there is no need to tell HMRC about it. All very easy!

Example 1
Gill lives near a park. During the summer, a number of events are held in the park, including open air concerts, sporting events, fayres and suchlike. Gill has a large drive which has parking for four cars. She provides parking during the summer for people attending events in the park, charging £10 per car.

During the 2018/19 tax year, Gill earns £420 from parking. She works full-time as a veterinary nurse and her personal allowance is fully used up against her wages. She has no other income from property or elsewhere. As the income from letting out her drive is less than £1,000, the whole amount is tax-free and does not need to be reported to HMRC.

Note: If Gill had made a loss, it would have been beneficial not to claim the allowance, so the loss could be carried forward for offset against any future property income.

Property income of more than the allowance

Where property income exceeds £1,000 in the tax year, the taxpayer has two choices:
1. deduct the £1,000 allowance from the receipts and pay tax on the excess; or
2. work out the profit or loss in the normal way.

The most beneficial option will depend on the level of the expenses.
If receipts exceed expenses, but expenses are less than £1,000, the best result is to claim the property allowance and pay tax to the extent that income exceeds £1,000. If expenses are more than £1,000, the best result will be obtained by working out the profit in the usual way, deducting allowable expenses from receipts.

Example 2
Richard owns a field near a stately home which he makes available to provide overflow parking for events at the stately home. In 2018/19, he earns £4,800 from parking receipts, and incurs expenses of £860.

If he calculates his profit in the usual way, his taxable profit is £3,940 (£4,800 - £860). However, if he claims the property allowance, his taxable profit falls to £3,800 (£4,800 - £1,000).

Claiming the allowance is therefore beneficial.

Employment allowance – have you claimed it?

The employment allowance is a National Insurance allowance which is available to qualifying employers. The allowance reduces employers' (secondary) Class 1 National Insurance by up to the £3,000.

The allowance is set at £3,000 or, if lower, the employers' secondary Class 1 bill for the tax year.

Who can claim?
Most employers, whether a company or an unincorporated business, are able to claim the employment allowance if they are paying employers' Class 1 National Insurance contributions. However, if there is more than one PAYE scheme, a claim can only be made for one of them.

Who can't claim?
The main exclusion is for companies, such as personal companies, where the sole employee is also a director. However, the allowance can be preserved if the sole employee is not also a director, or if the business has more than one employee.

Remember to claim
The employment allowance is not given automatically and must be claimed. This is done via the payroll software through RTI. Although, ideally, the claim should be made at the start of the tax year, it can be made at any time in the year.

Using the allowance
The allowance is set against the employers' Class 1 National Insurance liability for the tax year until it is used up, reducing the amount that the employer needs to pay over to HMRC.

Employment allowance – have you claimed it? - Continued

Example
XYZ Ltd has five employees. For 2018/19 prior to claiming the employment allowance, the employers' NIC bill is £534 per month.
XYZ Ltd claims the employment allowance at the start of the tax year. The allowance is used as follows:

Month	Allowance b/f	Employers' NIC	Allowance used	Allowance c/f	Employers' NIC paid to HMRC
1	£3,000	£534	£534	£2,466	£0
2	£2,466	£534	£534	£1,932	£0
3	£1,932	£534	£534	£1,398	£0
4	£1,398	£534	£534	£864	£0
5	£864	£534	£534	£330	£0
6	£330	£534	£330	£0	£204
7	£0	£534	£0	£0	£534
8	£0	£534	£0	£0	£534
9	£0	£534	£0	£0	£534
10	£0	£534	£0	£0	£534
11	£0	£534	£0	£0	£534
12	£0	£534	£0	£0	£534

For the first five months of the tax year, there is no employers' NIC to pay over to HMRC as it is offset by the employment allowance. The balance of the allowance is used up in month 6, reducing the employers' NIC payable to HMRC for that month to £204. For month 7 onwards, there is no allowance remaining and the full amount of the employers' NIC (£534 per month) must be paid over to HMRC.

Unused allowance
If the employers' NIC bill for the year is less than £3,000, the unused amount cannot be carried forward or set against other liabilities. The allowance is capped at the employers' Class 1 NIC bill for the year. It cannot be set against Class 1A or Class 1B liabilities, or against employees' NIC.

However, if the claim is made too late in the year to set all the available allowance against the employers' NIC liability, the employer can ask HMRC to set it against other tax and National Insurance liabilities, if there is no PAYE owed; or the employer can ask HMRC for a refund

Are your workers employees?

Employee status continues to be in the spotlight. The Government are consulting on proposals to address non-compliance with the off-payroll working rules in the private sector. Earlier in the year they consulted on employment status, including the possibility of introducing a statutory employment status test.

It is important that the status of workers is correctly assessed as this will affect the tax and National Insurance that the worker pays, and consequently the state benefits to which they may be entitled, and also the extent to which they are able to benefit from employment rights. It will also determine whether the engager must operate PAYE and pay employer's National Insurance contributions.

Current approach
While change is likely, under the current rules there is no single test that determines whether a worker is an employee or is self-employed. Rather it is a case of looking at the characteristics of the engagement and standing back and seeing whether the picture that emerges is one of employment or self-employment.

Employee v self-employed
An employee works under a contract of service whereas a self-employed person enters into a contract for service.
The following table summarises some of the key indicators of employment and self-employment.

Employment	Self-employment
The employer is obliged to provide work and the worker is obliged to do it.	The worker is in business on their own account.
The worker must work regularly unless on leave.	The worker bears the financial risk.
The worker is required to work a minimum number of hours at set times.	The worker is generally paid a price for the job, regardless of how long it takes.
The worker must do the job personally.	The worker does not have to do the work personally and can send a substitute.
The worker is supervised and told what work to do.	The worker can decide when and how to do the job.
The worker is entitled to paid holiday.	The worker does not get paid while on holiday.
	The worker decides what jobs to take on.
The worker is entitled to join the workplace pension scheme.	The worker is responsible for correcting unsatisfactory work and must bear the cost of doing so.
The worker receives employment-type benefits.	

Are your workers employees? - Continued

Employment	Self-employment
The worker is given the tools and equipment needed to do the job.	The worker provides the tools and equipment needed to do the job.
The employer deducts PAYE and National Insurance contributions from the employee's pay.	The worker invoices for their work and is paid gross, without the deduction of tax and National Insurance.
The worker is `part and parcel' of the organisation.	The worker is responsible for the financial success of the business.
The worker is included in company social events, such as the staff Christmas party.	The worker is not part of the organisation and is not invited to social events.

Marginal cases
It will often be clear cut as to whether a worker is employed or self-employed and the characteristics of the engagement will fall securely into one camp or the other. However, this will not always be the case; in marginal cases, the worker may exhibit characteristics of each. In such case, HMRC produce a 'Check Employment Status Tool' (CEST), which can be used to help reach a decision as to whether the worker is an employee or self-employed.

Is the VAT flat rate scheme for me?

The VAT flat rate scheme (FRS) is a simplified VAT scheme that enables VAT registered business to work out how much VAT they need to pay over to HMRC by applying a flat-rate percentage to their VAT-inclusive turnover. However, VAT cannot be reclaimed on purchases (with an exception for certain capital assets over £2,000). The flat rate percentage depends on the business sector in which they operate, and also whether they are classed as a `limited cost business' and have an `allowance' built in for VAT on purchases.

Who can join the FRS?
A trader wishing to join the FRS must have VAT-exclusive turnover of £150,000 or less. An application to join the scheme can be made on-line, or by post (on form VAT600 FRS). Once in the scheme, a trader can remain in it unless, on the anniversary of joining, their turnover was £230,000 or more in the last 12 months, or is expected to be in the next 12 months. A trader must also leave the FRS if they expect their total income in the next 30 days to top £230,000.

What is the flat rate percentage?
The flat rate percentage depends on the sector in which the business operates. The percentages are available on the Gov.uk website. A discount of 1% is given for the first year that the trader is in the scheme. Where the trader is a limited cost business, the flat rate percentage is 16.5%.

What is a limited cost business?
A limited cost business is one where the 'spend' on `relevant goods' is either:

- less than 2% of the VAT flat rate turnover; or
- more than 2% of VAT flat rate turnover but less than £1,000 a year.

If the period is less than one year, the £1,000 threshold is proportionately reduced (so £250 per quarter).
What counts as 'relevant goods' is set out in VAT Notice 733. It includes things like stationery, gas and electricity used in the business, stock, food used in meals sold to customers, fuel used by a taxi business and suchlike. It does not include services, such as accountancy and legal fees, downloadable software, rent, postage, and fuel other than where the business is in the transport sector.

Working out the VAT to pay
One of the main advantages of the FRS is that working out the VAT to pay to HMRC is easy. It is simply a case of multiplying the VAT-inclusive turnover for the quarter by the flat-rate percentage for the business sector.

Example
Paul runs a toy shop and has done for a number of years. For a particular VAT quarter, his VAT-inclusive turnover is £22,000. His flat rate percentage for his sector is 7.5% (retail not listed elsewhere). He is not a limited cost business.
For the VAT quarter he must pay VAT of £1,650 over to HMRC (£22,000 @ 7.5%).

Advantages
The main advantage is one of simplicity. The trader does not need to keep a record of VAT on purchases. The 1% discount in the first year may generate a welcome bonus.

Disadvantages
It may be more costly being in the scheme, particularly for limited cost businesses, who get virtually no relief for any VAT they incur. The flat rate percentage for a limited cost business is 16.5% of VAT-inclusive turnover, which is equivalent to 19.8% of VAT-exclusive turnover; consequently a limited cost business pays over virtually all the VAT charged to customers to HMRC.

Is it for me?
To decide whether the VAT FRS is for you compare what you will pay under the scheme with that payable under normal rules, and factor in the added convenience of the scheme. Then weigh it up.

Client Focus- Meet Katherine and Terri from Vintage Inspired!

This month we catch up with Katherine and Terri, owners of the new boutique and online vintage clothing shop, Vintage Inspired…

It was through their common interest of dance and all things vintage that Katherine and Terri met and when Terri discovered Katherine had plans to open up a boutique selling vintage clothing and accessories, a partnership in retail was born.

Having launched the boutique based in Gosport only a few weeks ago, Vintage Inspired has already got off to a successful start with Katherine and Terri receiving great interest from the public.

Vintage Inspired is a predominantly online business, but not limited to the Internet, as it was Terri and Katherine's intention to create a ladies boutique boudoir that allows their clients to come in, peruse the garments available, and experiment with various vintage styles.

Katherine explains, "As well as offer online products, we also wanted to create an environment whereby people could come in and try on a garment from the vintage era that they might not ordinarily wear, to open up their opportunities and have some fun. We are also offering this to small groups of ladies for hen parties and events that may wish to explore and experiment with a vintage style, with hair and makeup and even a glass or two of bubbles!"

As well as selling online and in the boutique, a great deal of Vintage Inspired's custom is generated at various events. "We are involved in a whole range of different events and sell garments at revival weekends, such as Southwick Revival as well as military events, or occasions that don't particularly have a vintage theme." adds Katherine.

A large majority of the clothing Vintage Inspired sell is from vintage manufacturers, Lindy Bop - a company famous for its unique, highly collectable, limited edition, vintage prints. Vintage Inspired sell the company's end of line stock and returns at a fraction of the original cost.

Whilst Vintage Inspired has got off to a flying start, Katherine and Terri have not always been in the retail market. "This is relatively new to us" explains Terri, "Katherine is a qualified teacher working in parent support, and I was formerly a support worker, working with adults with challenging behaviour and learning difficulties."

"Despite not having a background in retail, we have the skill set between us to develop, and have the capacity to understand which direction we need to go in." adds Katherine. "We have been fortunate enough to have some very good connections in the industry that we hope to develop further."

Looking to the future, Vintage Inspired already has aspirations to gain a stronger foothold in the online market, and raise its presence further. "We want to really develop the online aspect of our custom, and have already appointed someone to develop our online presence and increase our Internet sales." says Terri. "We are also looking to attend workshops to learn how to develop more vintage hairstyles to broaden our offering for hen parties and ladies team building events."

"Compass have been incredible- and we are so pleased to have them on-board." says Katherine. They have really been a great help. They have supported us, in every step of our journey. They came to our opening -which they covered on their social media- they have been easy to talk to, very approachable and the work that they have done was completed within a very tight deadline. We have been very impressed and have already recommended them to our own contacts!"

For more information on Vintage Inspired- visit: www.vintageinspired.co.uk to contact Katherine or Terri, or to see the Vintage Inspired clothing range,

Or pop in and browse the vintage clothing, visit First Floor, 95 Priory Road, Hardway, Gosport on Tuesday, Wednesday and Thursday between 10am and 3pm.

Tax Diary
August 2018

1 August 2018 - Due date for Corporation Tax for years ended 31 October 2017.

19 August 2018 - PAYE and NIC deductions due for month ended 5 August 2018. (If you pay your tax electronically the due date is 22 August 2018)

19 August 2018 - Filing deadline for the CIS300 monthly return for the month ended 5 August 2018.

19 August 2018 - Due date for CIS tax deducted for the month ended 5 August 2018.

Contact us

For further information on any of the stories in this month's newsletter, or for any other matter that Compass Accountants can assist you with, please contact us on 01329 844145.

Compass Accountants

Venture House,
The Tanneries, East Street, Titchfield
Hampshire
PO14 4AR

Contact us:
TEL: 01329 844145 or 02393 233196
EMAIL: contact@compassaccountants.co.uk