COMPASS ACCOUNTANTS

TAX ANGLES FOR PROACTIVE PLANNING

Newsletter - December 2019

In this month's edition…

Relief for trading losses

In the event that a loss arises in a trade or profession, consideration should be given as how best to obtain relief for that loss. As with many things, there is no 'one size fits all' and the best option will depend on the trader's particular circumstances.

Option 1 – Relief against general income

If the trader has other income, one of the easiest (and quickest) ways to obtain relief for the loss is to set against general income. However, this option is only available where accounts are prepared using the traditional accruals basis; traders using the cash basis cannot relieve a trading loss in this way.

A claim can be made to relieve the loss against:

- Income of the same tax year;
- Income of the previous tax year;
- Income of both the current and the previous tax years.

If the trader wishes to relieve the loss against the income of the current and the previous tax year, they must choose which year has priority. The income of the priority year must be completely extinguished before the balance of the loss can be set against the other year; it is not possible to make a partial the claim and tailor the relief, for example, to preserve personal allowances.

If the individual does not have sufficient income in the current or previous tax year, but has a capital gain, the relief can be extended to capital gains (net of capital losses but before the annual exempt amount).

When choosing whether to relieve the loss in this way, consideration should be given to preserving personal allowances. If other income in the year is sheltered by personal allowances, there is little benefit in making a claim against general income.

Option 2 – Against later profits of the same trade

A loss arising in a trade or profession can be carried forward and set against future profits of the same trade. However, the loss must be set against the first tax year in which a profit arises – again it is not possible to tailor claims to preserve personal allowances. If the loss is not fully utilised against the first year in which a profit arises, the unused balance must be set against the next tax year in which a profit arises.

Option 3 – Relieving an early year loss

If the trade is relatively new, the trader may be able to benefit from a special relief that applies to losses made in the early years of the trade. Under this relief, a loss that is made in the year that the trader starts to trade or any of the three subsequent years (i.e. the first four years of the trade) can be carried back and set against total income of the three years before the tax year in which the loss was made, with earlier years taken in priority to later years.

This option is not available where accounts are prepared using the cash basis.

Mileage allowance payments – what is NIC-free?

Employees frequently use their cars for work and may be paid a mileage allowance by their employer for doing so. Employers are generally familiar with the rates that can be paid tax-free; however, it is easy to assume (wrongly as it happens) that the same rules apply for National Insurance purposes. While it is true that mileage allowances can be paid NIC-free up to certain limits, there are differences in the rules.

Recap – The tax rules

Under the approved mileage allowance scheme, as long as employers do not pay a mileage allowance for business travel that is more than the 'approved amount', the allowance can be paid tax-free and does not need to be reported to HMRC. The approved amount is simply the number of business miles in the tax year multiplied by the relevant approved mileage rate. The rate for cars and vans is 45p per mile for the first 10,000 reimbursed business miles in the tax year and 25p per mile for any subsequent business miles.

If the amount paid exceeds the approved amount, the excess is taxable and must be reported on the employee's P11D. By contrast, if the allowances paid by the employer are less than the approved amount, the employee can claim tax relief for the shortfall.

NIC rules

Unlike PAYE, NIC does not work on a cumulative basis – in determining the NIC liability for a particular earnings period, only the earnings for that period are taken into account. As a result of the non-cumulative nature of NICs, when looking at mileage payments, only those paid in the particular earnings period are relevant – it is not necessary to look at the position for the whole year. A consequence of this is that the 45p per mile rate for cars and vans applies for NIC purposes to all reimbursed business miles in the tax year, not just the first 10,000.

The terminology for National Insurance purposes is different too – rather than the 'approved amount' the relevant amount is the 'qualifying amount' (QA). As long as the mileage payments paid in the earnings period are not more than the qualifying amount, they are NIC-free.

The qualifying amount is found by the formula M x R where M is the number of business miles for which payment is being made and R is rate applicable to the vehicle at time that the payments were made. The rates are as follows:

- 45p per mile for cars and vans
- 24p per mile for motorcycles

If the mileage payments in the period (referred to as 'relevant motoring expenditure' (RME) exceeds the qualifying amount, the excess is earnings for NIC purposes (but not for PAYE). Consequently, this excess is included in gross pay for NIC purposes but not for PAYE purposes – any excess over the approved amount for tax purposes is reported on the P11D.

Example

Michelle uses her car for work. She is paid monthly. In one particular month she drives 750 business miles. Her employer pays a mileage allowance of 50p per mile.

The mileage payments made to Michelle in the month are therefore £375 (750 miles @ 50p per mile) and the qualifying amount is £337.50 (750 miles @ 45p per mile). As the payments (RME) exceed the qualifying amount (QA), the excess of £37.50 (£375 - £337.50) is treated as earnings and included in gross pay for NIC purposes.

Annual investment allowance or writing down allowance?

The way in which relief for capital expenditure is given depends on the way in which the accounts are prepared. For companies, and for sole traders and partnerships not eligible to use the cash basis, accounts must be prepared using the traditional accruals basis.

Under the accruals basis, a deduction is not permitted for capital expenditure when computing profits; instead relief is given in the form of capital allowances. By contrast, where accounts are prepared using the cash basis, capital expenditure can be deducted in computing profits unless the expenditure is of a type for which a deduction is expressly denied, as is the case for expenditure on land, buildings and cars.

AIA v WDA

There are two main types of capital allowance available for expenditure on plant and machinery – the annual investment allowance and writing down allowances. The annual investment allowance (AIA) gives an immediate deduction against profits, whereas the writing down allowance (WDA) provides a deduction over a number of years (the tax equivalent of depreciation).

Nature of the AIA

The annual investment allowance allows a business to deduct the full cost of an item when calculating taxable profits, as long as the available annual investment allowance is sufficient and the expenditure is qualifying expenditure.

It can be claimed on most items of plant and machinery, but is not available in respect of cars.

The AIA limit is set at £1 million from 1 January 2019 to 31 December 2020. It is due to revert to the normal level of £200,000 from 1 January 2021.

Where the accounting period falls wholly within the period from 1 January 2019 to 31 December 2020, the AIA limit is £1 million; where it spans either of these dates, transitional rules apply to determine the limit – check your limit for these periods with us.

Nature of WDAs

Writing down allowances may be claimed where the AIA is not available, either because the limit has been used up or because the expenditure is of a type, such as that on cars, which does not qualify for the AIA. There are different rates of writing down allowance.

Items in the main rate pool attract a writing down allowance of 18%.

The allowance is calculated on a reducing balance basis. Items are allocated to the main pool unless they are of a type that must be allocated to a single rate pool or they are in a single asset pool. Cars with CO2 emissions of more 130g/km or more, features integral to a building, long life assets or thermal insulation are allocated to the special rate pool, which has a lower rate of writing down allowance of 6%. Some assets, such as new cars with CO2 emissions of 50g/km or less qualify for 100% first year allowances.

AIA or WDA – which is better

Although the AIA provides immediate relief for expenditure, claiming the AIA will not always be the best option. If the trader is only planning to keep the asset for a short time, claiming the AIA now may trigger a large balancing charge on disposal – this may be something that the business wishes to avoid.

It may also be preferable to claim a writing down allowance where claiming the AIA would result in the personal allowance being wasted or create a loss.

There is no one size fits all – discuss the best option for your business with your accountant. Remember you can tailor the claim; it is not mandatory to claim the AIA on the full amount of the expenditure. However, the AIA can only be claimed in the period in which the expenditure is incurred. After that, any balance must be relieved by claiming WDAs.

Gift cards and the trivial benefits exemption

The trivial benefits exemption allows employers to ignore benefits in kind that cost £50 or less for tax purposes, as long as the conditions of the exemption are met. Where the exemption applies the benefit does not need to be reported to HMRC.

Staying within the scope of the exemption is perhaps easier said than done.

To qualify, the benefit must not be provided as a reward for services. This means, for example, giving an employee a bunch of flowers as a thank you for staying late to meet a deadline will not fall within the scope of the exemption, even if the flowers cost the employer £50 or less.

Further, the exemption only applies to benefits in kind – cash or vouchers which are exchangeable for cash do not qualify. The exemption is also lost if provision is made via a salary sacrifice scheme.

Unless the employee is a director of a close company, there is no limit on the number of tax-free trivial benefits that can be provided in a tax year; close company directors are subject to an annual cap of £300.

The problem with gift cards

HMRC have recently drawn attention to a potential problem that may arise where an employer uses a gift card to provide an employee with trivial benefits.

It is easy to see how an employer who tops up a gift card several times a year would be confident that the trivial benefits exemption applies, provided that each top up is less than £50 and the other conditions are met.

However, rather than considering each top-up in isolation, HMRC's approach is to treat the gift card as a single benefit and look at the total amount put on the gift card in the tax year – if this is more than £50, their view is that the trivial benefits exemption does not apply.

Example

An employer is keen to make use of the trivial benefits exemption to provide employees with tax free benefits. The employer provides each employee with a gift card at the start of the tax year with a balance of £30. The employer then tops up the gift card by £30 each month. The gift card can only be used for purchases; it is not exchangeable for cash.

As each top up is less than £30, the employer thinks that the trivial benefits exemption is in point and does not report the benefit to HMRC. However, from HMRC's perspective, the employer has provided employees with a benefit that cost £360 for the tax year – as this is more than £50 the trivial benefits exemption does not apply.

The solution

Employers should avoid topping up gift cards – this trap can be avoided by providing employees with a separate gift card each month. Changing the nature of the gift card each time further supports the view that each benefit stands alone.

Should an LLP partner be treated as a salaried partner?

As a general rule, the individual partners in a partnership are treated as self-employed for tax purposes. Consequently, they pay tax under the self-assessment system and pay Class 2 and Class 4 National Insurance contributions on their profits.

However, in a limited liability partnership (LLP), some of the partners are more like employees in nature than partners in a traditional partnership. In recognition of this, legislation was introduced to treat such partners as employees rather than as self-employed partners, with the upshot that they are taxed on their partnership earnings ('salary') under PAYE rather than under self-assessment, and they pay Class 1 National Insurance rather than Classes 2 A and 4.

The rules
The salaried partner treatment only applies if all of the following three conditions are met.

Condition A is met if the partner receives a reward that is more like a salary than a share of business profits.
An amount falls within this condition if:

- it is fixed;
- it is variable but without reference to the overall amount of the profits of the LLP; or
- it is not, in practice, affected by the overall profits and losses of the LLP

However, it should be noted that payments made on account of a profit share are not treated as disguised salary and the payments are contingent on future profits being made.

Condition B is met if the mutual rights and duties of the members of the LLP and the rights and duties of the LLP and its members do not give the individual significant influence over the affairs of the LLP.

This condition seeks to identify partners who do not have significant influence – in a traditional partnership, the partners are in business together and have an influence on how business is done and the decisions made. A partner who is more like an employee will lack that degree of influence.

A partner will, however, be regarded as having significant influence if they are involved in the day-to-day management. Partners acting in a senior management role who may leave the day-to-day running to others but who can exert significant influence over the strategic decision of the business will also be regarded as having significant control.

Condition C is met if the individual's capital contribution is less than 25% of the disguised salary which it is reasonable to expect will be received by the partner in return for the services that they perform for the LLP. New partners are allowed two months in which to contribute the capital.

Implications
Where all of the above conditions are met by a partner of an LLP, the partner must be treated like an employee for tax and National Insurance purposes. Payments treated as salary are taxed under PAYE and the employee must pay Class 1 National Insurance contributions. The LLP must also pay secondary Class 1 National Insurance.

Client Focus - Meet Andy Williams

This month, we catch up with SEO Consultant and Compass client, Andy Williams….

Andy Williams is an award-winning SEO consultant with over 16 years of experience in the market. Over the years, Andy has built a strong portfolio of clients including charities and businesses, helping them to vastly improve their online potential. With background of working for a digital marketing agency, Andy made the decision to go solo over four years ago and hasn't looked back.

Andy's service is built around flexibility, which means organisations of all sizes and in all sectors can access his services, as he explains, "I base my service around the needs of the client so if they are a big company, I can go in and work as a part of their team on long term projects, or I can work with smaller organisations who may wish to use my consultancy services for one-off, smaller projects, to identify where they could raise their online potential."

"For example, a lot of small businesses come to me and say –'we aren't ranking very well- how can you help?', and so I come in and work through the basic steps and provide them with an audit of their website. Often that is enough to optimise their site for local intent- but local SEO has become more competitive and therefore more complex."

"Larger clients may hire my services for a couple of years to iron out issues and maybe help launch and establish a whole new website. A big problem for a lot of companies is that they set up the wrong key words or phrases as they are unaware of the language their target audience uses when searching. Some businesses use language that is more internal, or familiar to them than the average person. Successful SEO is about doing your keyword research and knowing what your audience is looking for."

"It is also ever evolving, so you have to consider the big picture, as well as key words you have to know your audience and provide content that will appeal to them. You have to maintain this content through PR and social media – it's actually a massive outreach exercise."

Having been in the industry for over 16 years, Andy has come across virtually all issues that have occurred over this time- he continues, "I've seen all the updates, advances in new methods, and the spam tactics of the past, in fact I have helped a lot of businesses to undo most of them. I've seen the whole sector evolve."

Working with Compass Accountants

It was over four years ago when Andy decided to go freelance. Around the time of making the leap, Andy began a search for the right accountant. "I was looking for an accountant and through word of mouth someone recommended Compass. I went in to meet them and after a chat, I knew they were right for me. They've been my accountants ever since and have really looked after me. They make sure I'm on the right lines, I've been really happy with the way they work. I am always confident they'll do what is needed. Compass also helped me with the transition of being a freelancer. They made it simple and easy. I didn't have to look anything up or really do much at all. There were things I didn't understand and still don't to this day, but if I need to know anything, they talk me through the whole thing. Compass completely look after the finance side of things for me. They make running a business a walk in the park."

If you would like to find out more about Andy's service and how he could improve your SEO – email him at andy@andywilliamsseo.com or go to www.andywilliamsseo.com/

Tax Diary
December/January 2019/20

Christmas party season

No taxable benefit provided cost per head does not exceed £150 (inclusive of VAT).

1 December Advisory fuel rates reviewed by HMRC.

30 December Deadline for individuals to submit self-assessment tax returns if requesting under-payments of tax of £3,000 or less to be collected through 2020/21 PAYE code.

31 December Corporation tax returns filed by companies with 31 December 2018 year end. Submission of refund claims under the 13th Directive for VAT incurred in the EU by non-EU businesses in the year ended 30 June 2019.

Accounts for private companies for the year ended 31 March 2019 filed with Companies House.

1 January Payment of corporation tax by companies with 31 March 2019 year end.

14 January Form CT61 filed and tax paid for the quarter ended 31 December 2019.

31 January Online submission deadline for 2018/19 self-assessment income tax returns.

Balancing payments of income tax for 2018/19 and first payment on account for 2019/20. Payment of capital gains tax for 2018/19.

Deadline for making Gift Aid donations to carry back to 2018/19 (provided tax return not submitted earlier).

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.

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