COMPASS ACCOUNTANTS

TAX ANGLES FOR PROACTIVE PLANNING

Newsletter - June 2018

In this month's edition…

- Quote of the month
- Extracting profits as dividends
- Interest relief for landlords - the next stage
- Reporting benefits in kind for 2017/18
- Help to save
- Jointly-owned property - how is income taxed?
- Client Focus - Carolyne Foster

Extracting profits as dividends

Dividends provide an opportunity to extract profits in a tax-efficient manner. As a rule of thumb, it is generally tax-effective to take a salary equal to the primary and secondary threshold for National Insurance purposes or the personal allowance (set at £11,850 for 2018/19), depending on whether the employment allowance is available (or the recipient is under 21). Thereafter, it is tax efficient, where possible, to extract any further profits as dividends. However, it is not as straightforward as deciding to pay a dividend rather than a salary and certain boxes must be ticked.
In order to pay a dividend:

- the company must have sufficient retained profits to cover the dividend;
- pay the dividend in proportion to shareholdings; and
- ensure that it is properly declared.

Dividend rather than salary
Once the optimal salary has been paid, the tax hit on dividends is less than on salary. This is predominantly due to the fact that dividends do not attract National Insurance contributions, whereas a salary will attract employee's and employer's National Insurance contributions. Dividends are also taxed at a lower rate of tax than salary payments, and benefit from a tax-free dividend allowance. On the downside, dividends are paid from post-tax profits which have suffered a corporation tax deduction (at 19% for the financial year 2017 and 2018). Even allowing for that, the tax taken from paying dividends is lower.

Dividend allowance
All taxpayers, regardless of the rate at which they pay tax, are entitled to a dividend allowance. The allowance is £2,000 for 2018/19; reduced from £5,000 for 2016/17 and 2017/18.
The allowance is not an allowance as such, but rather a nil rate band which uses up part of the band in which it falls. Dividends, taxed as the top slice of income, are taxed at a zero rate to the extent that they are covered by the allowance.

Dividend tax rates
The dividend tax rates are lower than the usual income tax rates. Dividends are taxed at 7.5% to the extent that they fall within the basic rate band, 32.5% to the extent that they fall within the higher rate band and 38.1% to the extent that they fall within the additional rate band.

Case study 2018/19
Tim is the director of a family company. He decides to take a salary of £11,850 in 2018/19, which is equal to his personal allowance. He anticipates making a profit of £60,000 in the year to 31 March 2019 and wants to know whether it is better to extract it as salary or dividends.

If he takes a further salary (or bonus), after allowing for employer's National Insurance, he will receive a gross salary of £52,724, the first £34,500 of which will be taxed at 20% and the remainder at 40%.

By contrast, if he takes a dividend, the profit of £60,000 will suffer corporation tax of 19%, leaving £48,600 to be paid out as a dividend. The first £2,000 of this will be tax-free, the next £32,500 will be taxed at 7.5%, and the balance will be taxed at 32.5%.
The position is summarised below:

	Salary £	**Dividend** £
Profits	60,000.00	60,000.00
Corporation tax	-	(11,40.00)
Employer's NIC (£52,724 @ 13.8%)	(7,276.00)	-
Employees NIC ((£34,500 @ 12%) + (£18,224 @ 2%))	(4,504.48)	-
Income tax – salary ((£34,500 @ 20%) + (18,224 @ 40%))	(14,189.60)	-
Dividend tax ((£2,000 @ 0%) + (£32,500 @ 7.5%) + (£18,224 @ 32.5%)	-	(8,360.30)
RETAINED	£34,029.92	£40,239.70

By choosing to extract the profits as a dividend rather than as a salary, Tim if more than £5,000 better off.

Quote of the month…

"The future starts today, not tomorrow"
- Pope John Paul II

Interest relief for landlords – the next stage

The way in which landlords can obtain relief for interest payments and other finance costs is moving gradually from relief by deduction to relief as a basic rate tax reduction. Where the landlord pays tax at a rate above the basic rate, the value of that relief will gradually reduce.

The change is being phased in over four years. The process began in 2017/18 with a move from full relief as a deduction in calculating taxable profits to a hybrid situation whereby relief for 75% of the interest costs is given as a deduction in calculating taxable profits and the remaining 25% as a basic rate tax deduction. Landlords will need to use the new rules when working out their taxable profits for 2017/18.

The start of the 2018/19 tax year brings with it the next phase of the shift - for 2018/19, landlords will receive relief for 50% of their interest costs as a deduction and the remaining 50% as a basic rate reduction.

The following case study shows what impact this change has on a particular landlord.

Case study
Raj has two investment properties that he lets out. He also works in IT, earning a salary of £50,000. He pays tax on his rental profits at 40%.

In 2017/18 and 2018/19, his rental income is £25,000. He has interest costs of £10,000 and other expenses of £3,000.

In 2017/18, he can deduct £7,500 (75% of £10,000) in calculating his rental profit. Relief for the remaining £2,500 is given as basic rate tax reduction of £500 (£2,500 @ 20%).

In 2018/19, he can deduct £5,000 (50% of £10,000) in calculating his rental profit. Relief for the remaining £5,000 is given as a basic rate tax reduction of £1,000 (£5,000 @ 20%).

The tax payable for each year is calculated as follows

	2017/18	2018/19
	£	£
Rental income	25,000	25,000
Expenses	(3,000)	(3,000)
Interest deduction	(7,500)	(5,000)
	(10,500)	(8,000)
Taxable rental profit	14,500	17,000
Tax @ 40%	5,800	6,800
Basic rate tax reduction	(500)	(1,000)
Tax	(5,300)	(5,800)

The profits retained by Raj for each year are as follows:

	2017/18	2018/19
	£	£
Rental income	25,000	25,000
Interest costs	(10,000)	(10,000)
Other expenses	(3,000)	(3,000)
Tax	(5,300)	(5,800)
RETAINED	6,700	6,200

As a result of the shift, Raj gets to keep £500 less of his rental income in 2018/19 than in 2017/18, despite the fact that nothing has changed.

Looking ahead
The shift continues in 2019/20. For that year, relief for 25% of interest costs will be given by deduction and the remaining 75% as a basic rate tax reduction. From 2020/21 onwards, relief will only be available as a basic rate tax deduction.

Reporting benefits in kind for 2017/18

Taxable expenses and benefits provided to employees during the 2017/18 tax year need to be reported to HMRC on form P11D unless:

- the benefit has been payrolled;
- it has been included in a PAYE Settlement Agreement; or
- it is covered by an exemption.

The form must be filed by 6 July 2018, along with a form P11D(b), which is also the Class 1A return. A P11D(b) is needed even if all taxable benefits have been payrolled and, as a result, there are no P11Ds to submit.

What to report?
The amount that is reported is the cash equivalent value. This will be either the amount calculated in accordance with the rules for that particular type of benefit (such as those for company cars and fuel, employment-related loans and suchlike), or where no special rule exists, by reference to the general rule of cost to employer, less any amount made good by the employee.

Interest relief for landlords – the next stage - Continued

Salary sacrifice arrangement – special valuation rules
From 6 April 2017 onwards, new valuation rules apply to most benefits if they are made available under an optional remuneration arrangement, such as a salary sacrifice arrangement, or where a cash alternative is offered instead. Where the rules bite, the value to be reported is the salary foregone or cash alternative offered, if this is higher than the cash equivalent calculated under normal rules. Any amount made good is deducted as usual. The P11D has been amended to allow for these new rules; the boxes now refer to `cost/market value or amount foregone'.

The rules do not apply where the benefit is one of the following:

- payments into pension schemes;
- employer-provided pension advice;
- childcare vouchers, workplace nurseries, and directly contracted employer-provided childcare;
- bicycles and cycling safety equipment, including cycle to work schemes; and
- low emission cars (Co2 emissions of less than 75g/km).

Instead, normal rules apply.
For 2017/18, the rules can also be ignored where the arrangement was in place at 5 April 2017 and has not been renewed or modified prior to 6 April 2018. Transitional rules delay the start date until 6 April 2021 for arrangements in relation to a car (other than an ultra-low emissions car), living accommodation or school fees, and 6 April 2018 in all other cases where the arrangement was in place at 5 April 2017, or the date that the arrangement is renewed or varied, if this is earlier.

Submitting the forms
There are various submission options available and while most employers find it easy to file online, this is not compulsory. HMRC offer a number of online options – their online end of year expenses and benefits service (see www.gov.uk/government/publications/paye-end-of-year-expenses-and-benefits-online-form) and PAYE Online for employers (see www.gov.uk/paye-online). You can also use your commercial payroll software. Paper forms may also be submitted.

Help to Save

The Help to Save scheme is a Government initiative which is designed to encourage those on low incomes to save. A carrot is provided in the form of a tax-free bonus, which could add up to £1,200 over four years.

Who can benefit?
The Help to Save scheme is only open to those meeting the eligibility criteria. Savers will qualify if they are a UK resident and entitled to Working Tax Credit and receiving Working Tax Credit or Child Tax Credit Payments, or claiming Universal Credit and have household or individual income of at least £542.88 for their last monthly assessment period. The scheme is also open to Crown servants and their spouse or civil partner, and members of the British Armed Forces and their spouse or civil partner if they meet these criteria, but live abroad.

Nature of the scheme
Under the Help to Save scheme savers are able to save up to £50 each month. At the end of two years, the saver will receive a government bonus based on the highest balance achieved of 50% of the amount saved. Savers who carry on saving will receive a further bonus after another two years, of 50% of their additional savings in that period. The maximum bonus is £1,200 payable to someone who saves £50 per month for four years.

Savings can be made in an online account available through Gov.uk.

Example
Tim is eligible for a Help to Save scheme, which he opens on 1 November 2018. He saves £50 into the scheme. On 31 October 2020, he has £1,200 in his account. He receives a tax-free bonus of £600 (being 50% of this amount). Tim continues to save £50 per month for a further two years, saving an additional £1,200 in this period. On 31 October 2022 he receives a further bonus of £600 (being 50% of his savings in the two-year period from 1 November 2020 to 31 October 2022). At the end of the four-year period, the balance on his account is £3,600 (plus any interest earned on the account).

This comprises £2,400 saved by Tim (£50 per month for 48 months) and tax-free bonuses of £1,200 (£600 in 2020 and £600 in 2022).

Start date
A trial for the scheme started in January 2018 and the intention is that it will be available generally to eligible savers from October 2018.

Jointly-owned property – how is income taxed?

Where property is owned jointly by two or more people, the way in which any income is taxed will depend on the relationship between the owners.

Scenario 1: Joint owners are not married or in a civil partnership
If the property is owned jointly and the joint owners are not married or in a civil partnership, any income arising from the property is usually taxed in accordance with their actual shares.

Example 1
Rose, Lily, and Poppy are sisters. They own a house in equal shares, which they let out. The rental profit for the tax year in question is £12,000. Each sister is taxed on her third of the income, i.e. £4,000.
However, the joint-owners do not have to share the income in proportion to their share in the property – they may agree a different split. Where this is the case, each joint owner is taxed on the income they actually receive.

Example 2
The facts are as in example 1, except that the sisters agree to share the income in the ratio 1:2:3.
For the tax year in question, Rose receives income of £2,000, Lily receives income of £4,000 and Poppy receives income of £6,000. Each is taxed on the amount they actually receive.

Trap
The share for tax purposes must be the agreed share – they cannot be taxed on a different split simply because this yields the lowest tax bill if this does not reflect the actual split. So, for example, if Poppy has no other income and Rose and Lily are both higher rate taxpayers, it is not possible for Poppy to be treated for tax purposes as is she receives all the profit, but for the profit actually to be shared in the agreed split or in accordance with their actual shares.
Scenario 2: Spouses and civil partners
Tighter rules apply where the property is owned jointly by spouses or civil partners. Where this is the case, the income is treated as arising to them in equal shares, regardless of their actual entitlement and beneficial ownership.
However, if they own the property in unequal shares, they can elect (on form 17) for their share of the income for tax purposes to match their actual shares in the property. Whether such an election is beneficial will depend on the rate at which each spouse/civil partner pays tax.

Example 3
Polly and Percy are a married couple. They have a rental property in which Polly has a 20% stake and Percy has an 80% stake. The rental income for the tax year in question is £10,000. Polly is a higher rate taxpayer and Percy is a basic rate taxpayer.
In the absence of an election, each spouse is taxed on income of £5,000.

If they were to make an election on form 17, Polly would be taxed on income of £2,000 and Percy on income of £8,000. The election would have the effect of moving income of £3,000 from the higher rate to the basic rate, saving the couple £600 (£3,000 @ 20%). The election is, therefore, beneficial.

However, if Polly had been a basic rate taxpayer and Percy a higher rate taxpayer, the election would not be worthwhile, as the transfer would be from basic to higher rate, costing the couple £600.

Tip
It is possible to change the underlying ownership to get the best tax result as for capital gains tax purposes a property can be transferred between spouses on a no gain/no loss basis. This can be changed prior to sale as a different split is preferable for capital gains tax purposes.

Client Focus - Carolyne Foster

This month, we catch up with Compass Client, Carolyn Foster, the owner of 'Olivia George' – a provider of wedding and prom dresses in Bursledon…

It was just over a year ago, that Carolyn Foster decided that she would open a shop that sold preowned designer wedding and prom dresses. Fast forward that year, and not only has she opened the doors to the business, but she is also swiftly developing a strong reputation with a growing clientele.

After a year of hard work and planning- Carolyn launched her new retail outlet in Bursledon where her customers now visit to peruse the many dresses she has in stock.
"I remember realising that there was a gap in the market," Carolyn says, "when I discovered that there was a great demand for ex-samples and pre-worn designer dresses. However, there were very few shops where you can actually browse and try on off-the-peg dresses. To add to that, I'd had a wedding dress that sat in its box for years and years. I'd always wanted to sell it but never got around to it." Carolyn decided that a shop where you can do both would be the solution.

I'd heard stories about people trying to save money when buying dresses, so they go online and buy from overseas retailers, like China. It wasn't uncommon for those people to experience disappointment when they receive the dress, due to its terrible quality. Often people would receive something that looked absolutely nothing like the picture they saw online."

"At Olivia George, we not only help people to sell their dresses, we also offer clients a place to actually go and physically examine or try on a dress. We offer the full experience, before you commit. We believe that people shouldn't have to take risks when buying a dress."
Providing dresses for school proms is another area for Carolyn's business she is growing. She adds, "We already have appointments for the forthcoming prom season and are expecting a great deal of enquiries around that time, as this is an area of huge demand. For the parents- like me- who don't want to spend huge amounts on prom dresses, we provide an alternative, without having to compromise on quality."
Carolyn currently works in the shop with her colleague, Suzanne. The next step for Carolyn is to eventually grow the business by taking on more staff and later to expand the size of the premises.

"Compass have been so great and so helpful throughout this launch." Carolyn says. "I have known about Compass for many years, so when I had this business idea- I knew that they would be ideal in helping me through the process of business development."

"Compass also introduced me to '*Enterprise First'* and to their contacts at Barclays- all of which really helped me to develop a proper business plan. They also helped me to develop many other strong business contacts and gave me much more than the normal advice you'd expect from an accountant. I only had a vague idea of what I wanted to do- Compass helped me to gain the confidence to run with the idea and provided me the full support I needed to actually launch my business."

If you would like to find out more about Olivia George, you can visit

Or email Carolyne on Caz0171@hotmail.co.uk

The website is currently under construction but will be available here when complete:
http://www.olivia-george.co.uk/

Or, you can contact Carolyn or Suzanne via her Facebook Business page:
https://www.facebook.com/loveoliviageorge/

Tax Diary
June/July 2018

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

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

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

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

1 July 2018 Due date for Corporation Tax for years ended 30 September 2017.

5 July 2018 Last date for agreeing PAYE Settlement Agreements for 2017-18.

6 July 2018 Due date for filing forms P9D, P11D and P11D (b).

6 July 2018 Last date for forms P9D and P11D to be given to employees.

19 July 2018 Pay Class 1A National Insurance (if you pay your tax electronically the due date is 22 July 2018).

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

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

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

31 July 2018 Due date for second Self-Assessment payment on account for the tax year ended 5 April 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.

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