COMPASS ACCOUNTANTS

TAX ANGLES FOR PROACTIVE PLANNING

Newsletter - March 2020

In this month's edition…

- Winding up your personal service company
- Using CEST employment status determinations
- Changing a will after death
- Giving money to charity to save inheritance tax
- The hidden risks of DIY probate

Winding up your personal service company

Come April, many workers who have been providing their services through an intermediary, such as a personal service company, may find that their company is no longer needed. This may be because they fall within the off-payroll working rules, with the result that because tax and National Insurance is deducted from payments made to the intermediary, the tax advantages associated with operating through a personal service company are lost. Alternatively, it may be because their end client does not want the hassle of operating the off-payroll working rules and has decided only to use 'on-payroll' workers, putting workers previously using personal service companies on the payroll.

Where the personal service company is not needed, the question arises as how best to wind it up and extract any remaining cash.

Striking off
Striking off can be an attractive option where the personal service company can pay its debts and has less than £25,000 left in the company to extract.

The advantage of this route is that sums paid out in anticipation of the striking off are treated as capital rather than as a dividend, with the result that the capital gains tax annual exempt amount, if available, can be used to reduce the taxable amount. Where entrepreneurs' relief is available, any taxable gain is taxed at only 10%. To qualify for this treatment, the company must be struck off within two years of making the last distribution.

If the amount left to extract is less than £25,000, but it would be preferable for it to be taxed as a dividend, for example, because the dividend allowance and/or the personal allowance are available or the distribution would be taxed at the lower dividend rate of 7.5%, striking off can still be used.

However, to prevent the capital treatment applying, it would be necessary to breach one of the conditions so that the dividend treatment applies instead. This can be achieved by waiting more than two years from the date of the last distribution before striking off.

Members' voluntary liquidation (MVL)
Where the funds left to extract are more than £25,000 and it would be beneficial for them to be taxed as capital – for example, to benefit from entrepreneurs' relief or to utilise an unused annual exempt amount, the members' voluntary liquidation (MVL) procedure can be used.

An MVL is a formal procedure; the director(s) must provide a sworn affidavit that creditors will be paid in full and a liquidator must be appointed.

Using CEST employment status determinations

Under the off-payroll working rules as extended from 6 April 2020, medium and large public sector organisations that engage workers who provide their services through an intermediary, such as a personal service company, must determine the status of the worker as if the services were provided directly rather than through an intermediary. If the worker is within the off-payroll working rules, the end client (or fee payer where different) must deduct tax and National Insurance from payments made to the worker's intermediary, and also pay employer's National Insurance.

Where the end client is a small private sector organisation, it is the worker's intermediary that must undertake the status determination in order to ascertain whether IR35 applies.

HMRC's CEST tool

HMRC's Check Employment Status for Tax (CEST) tool can be used to find out whether a worker is employed or self-employed or whether the off-payroll working rules apply. The CEST tool was updated and enhanced at the end of 2019 in preparation for the extension of the off-payroll working rules.

The tool asks a series of questions about the contractual relationship between the worker and the engager. The following information is required:

- details of the contract
- the responsibilities of the worker
- who decides what work needs doing and when and where
- how the worker is paid
- whether the engagement includes any corporate benefits or reimbursement of expenses

In order to reach a decision on the worker's status, the user works through the questions selecting the answer most appropriate to their circumstances from those available. The answers given are used to provide a result.

The tool can be used anonymously – there is no requirement to provide personal details.

It is not possible to save information entered into CEST so that the user can return to it later – it must be completed in one session.

Possible outcomes

The CEST tool will provide a result determined from the answers provided. These can be reviewed before obtaining the result.

The possible outcomes are:

- off-payroll working rules (IR35) do not apply
- off-payroll working rules (IR35) apply
- unable to make a determination (for whether the off-payroll working rules apply)
- self-employed for tax purposes for this work
- employed for tax purposes for this work
- unable to make a determination (for employed or self-employed for tax purposes).

The tool will provide a reason as to why CEST reached the determination it reached.

Reliance on decision

HMRC have confirmed that they 'will stand by the result produced by the service provided that the information is accurate, and is used in accordance with [their] guidance'. A copy of the output should be retained.

However, HMRC warn that they will not stand by results achieved using contrived arrangements.

Use by end clients

Medium and large private sector organisations and public sector bodies that use workers providing their services through an intermediary can use CEST to fulfil their obligation to make a determination under the off-payroll working rules.

They should print off the determination and give a copy of it with the reasons for it to the worker and other parties in the chain. They should also keep a copy.

Use by workers

Workers supplying their services to small end clients can use the CEST tool to check whether they need to apply the IR35 rules. Where they receive a determination under the off-payroll working rules, they can use CEST to check that they agree with it, and to challenge it if they do not.

Changing a will after death

As long as certain conditions are met, it is possible to change a will after death. This is known as a post-death variation, and it can be a useful tax planning tool.

A post-death variation can be made to:

- reduce the amount of tax payable
- to change who benefits under the will
- place the assets of the deceased into trust
- to provide for someone who was left out of the will

Conditions that must be met
In order to vary a will after the deceased has died, the following conditions must be met:

- it must be made within two years of the deceased's death
- all beneficiaries adversely affected by the variation must agree to it and be party to it
- it must be made in writing
- it must contain a statement of intent for tax purposes, specifying that the beneficiary/beneficiaries elect for the relevant statutory provisions to apply
- if the amount of tax payable as a result of the variation increases, the personal representative must be party to it and agree to it
- it must not be made in consideration for money or money's worth

Although there is no requirement for new beneficiaries to sign the deed of variation, this is often done as good practice.

Effect
Where a deed of variation is made, the will is treated as if applied, as so varied, at the date of the deceased's death.

Two-year window
There is a two-year window in which a deed of variation must be made.

It is possible that in the period between the date of death and the making of the deed of variation, changes have occurred. For example, the asset that is subject to the variation may have been sold. In this situation, the proceeds, rather than the actual asset, would be redirected as a result of the deed of variation.

Once made cannot be undone
Once a deed of variation has been made, it cannot be undone. It is therefore advisable to take advice prior to varying a will.

Example
Bill dies in October 2019 leaving an estate of £1.5 million split equally between his wife, Barbara, and his sons Simon and Philip.

The family agree to vary the will so as to leave everything to Barbara to benefit from the inter-spouse exemption.

Bill's unused nil rate band will be available on Barbara's death. Her will provides for everything to be left equally between her sons.

Simon and Philip must be agree to be party to the deed of variation as they are adversely affected by the redirection.

The deed of variation is made in February 2020. The changes are deemed to be effective from the date of Bill's death as if they represented his will at that time.

Giving money to charity to save inheritance tax

One way to reduce the amount that the taxman takes from an estate in inheritance tax is to make a donation to charity. This can be particularly tax effective. The donation is taken off your estate before inheritance tax is calculated, and if the donation is large enough – at least 10% of your net estate – the rate at which inheritance tax is levied on the remainder of the estate is reduced.

Making smaller donations
Even if the donation is less than 10% of the estate, it will be effective in reducing the amount of inheritance tax paid. This is because the donation is deducted from the net estate before working out the inheritance tax payable.

Example 1
An individual dies leaving a net estate (after allowing for the nil rate band and residence nil rate band) of £400,000. The estate is left to his children. Inheritance tax of 40% of the net estate is payable – an inheritance tax bill of £160,000. After inheritance tax, the children receive £240,000 in total.

Assume instead that the individual had left £20,000 to charity and the remaining £380,000 to his children. The inheritance tax bill will now be 40% of (£400,000 - £20,000), i.e. £152,000. Leaving £20,000 to charity saves £8,000 in inheritance tax. After inheritance tax, the children receive £228,000 and the charity £20,000 – a total of £248,000. The £20,000 gift to charity effectively costs the children £12,000.

Donations of at least 10% of the net estate
To encourage charitable giving on death, the rate of inheritance tax is reduced by 10% -- from 40% to 36% -- where at least 10% of the net estate is left to charity. The effect of this can be illustrated by the following example.

Example 2
An individual dies leaving a net estate of £1 million, split equally between his four children. Inheritance tax payable on the estate is £400,000 (40% of £1 million), leaving £600,000 after tax (£150,000 per child).

If instead the individual had left 10% of his estate to charity – equal to £100,000, the amount on which inheritance tax is payable is reduced to £900,000 and the rate of inheritance tax is reduced to 36%. The inheritance tax payable on the estate is now £324,000 – a reduction of £76,000.

The children receive £576,000 (£144,000 each) and the charity receives £100,000 – a total of £676,000.

The gift of £100,000 to the charity effectively costs the children £24,000 as a result of the inheritance tax savings.

Is it worth it?
It depends on your outlook. If the aim is to reduce the amount that the taxman gets or make a tax-efficient gift to charity, the answer is yes.

However, if the beneficiaries want to maximise the amount that they get from the estate, the answer is no. In each case, they are worse off by making the charitable donation than by taking the inheritance tax hit. While it may be preferable for money to go to charity rather than to HMRC, some of the charitable gift is coming out of their pocket.

Charitable giving can reduce the inheritance tax payable, but at a cost.

Deferring your state pension

If your contributions record is sufficient, you will be entitled to the state pension on reaching state pension age. The age at which you reach state pension age depends on when you were born.

To qualify for a full single tier state pension (set at £168.60 per week for 2019/20, rising to £175.70 per week for 2020/21), a person needs 35 qualifying years. A reduced pension is payable to someone who has at least 10 qualifying years, but less than 35. The single tier state pension is payable those reaching state pension age on or after 6 April 2016.

When you reach state pension age, you do not need to take your state pension immediately. You can instead choose to defer it, receiving a higher pension in return. The rules on deferred state pensions differ depending on whether state pension age was reached before 6 April 2016 or on or after that date.

The state pension is taxable.

State pension age reached on or after 6 April 2016

If you reach state pension age on or after 6 April 2016 and opt to defer your state pension, the amount that you receive when you start taking your pension will be increased, as long as you defer your pension by at least nine weeks.

The state pension is increased by 1% for every nine weeks by which the pension is deferred. Deferring the state pension for 52 weeks will increase it by just under 5.8%.

At the 2019/20 rate of £168.60 per week, deferring the state pension for 52 weeks will increase it by £9.74 per week. This will increase as the state pension increases.

Any deferred state pension is paid with the regular state pension and is taxable in the same way.

It is not possible to take a deferred pension as a lump sum where state pension age is reached on or after 6 April 2016.

State pension age reached before 6 April 2016

Different rules applied where state pension age was reached before 6 April 2016. Under the rules that applied at that time, the extra state pension could be used to increase the weekly pension payments or taken as a lump sum. Those reaching state pension age before 6 April 2016 receive, depending if the eligibility conditions are met, the basic state pension. This may be supplemented by the earnings-related second state pension.

The deferral rate was better under these rules too – the state pension was increased by 1% for every five weeks by which it was deferred. This is equivalent to an increase of 10.4% for every 52 weeks that the pension was deferred. For 2019/20 the basic state pension was £129.20 per week. It will increase to £134.25 per week for 2020/21. At the 2019/20 rate, deferring the pension for 52 weeks increases it by £13.44 per week.

Under the pre-April 2016 rules applying to those who reached state pension age before 6 April 2016, it is possible to take the deferred pension as a lump sum if it has been deferred for at least 12 months in a row. Interest is also paid at 2% above the Bank of England base rate. This can be taken in the year in which the state pension is claimed or the following year.

A deferred pension lump sum is taxed at the taxpayer's highest marginal rate on their other income when the lump sum is taken. So, if the taxpayer's other income in that year is covered by the personal allowance, the deferred pension sum will be tax-free, but if the taxpayer has other income and is taxable at the basic rate, they deferred pension lump sum will be taxed at the basic rate, even if this takes the taxpayer's total income into the higher rate band. It is taxed in the year in which it is taken

Deferring the state pension can be a useful way to increase your weekly pension if you do not need it immediately on reaching state pension age.

The hidden risks of DIY probate

When a loved one is lost, the person named as the executor of the will often considers handling the probate themselves to reduce costs. However, DIY probate comes with great risks, as making a mistake throughout this procedure can be extremely costly. Compass Accountants Director, Kerry Lawrance explains the importance of appointing an expert to ensure the process is managed correctly…

What is probate?

In essence, probate and estate administration is the financial and legal process which occurs after someone has died. The purpose of this is to ensure that relevant taxes are collected, any outstanding debts and monies are paid and the remaining assets from the estate are distributed to the relevant beneficiaries.

Whilst this can often be a complicated and a daunting procedure, it has been estimated that around a third of the UK's executors attempt to manage probate themselves.
Unfortunately, whilst a DIY option might seem like an easy way to save money, it can cause huge complications and costs in the long run.

Liability
Many people are unaware that executors are both legally and financially liable for any mistakes made whilst managing probate. This means that the beneficiaries can hold the executor personally accountable if poor administration causes a loss to the estate.

For example, if an incorrect property value is not obtained, and as a result a beneficiary does not receive the correct amount of money, this shortfall must then be paid by the executor. It is also the responsibility of the executor to ensure all liabilities and debts are paid, so if there are unpaid or outstanding bills for inheritance tax (or any other taxes), executors are entirely responsible. Furthermore, HMRC has also clamped down on inheritance tax administration errors, meaning penalties can be particularly severe.

Time, effort and complication

If you practice something once, or maybe twice in a lifetime, it's highly unlikely you will have mastered it. In our experience, people considering DIY probate, often underestimate the complication, time and effort the procedure requires.

Applying for the grant of probate, having the estate valued, completing paperwork and undertaking the general administration of a probate procedure, can be not only challenging, but also extremely time consuming, especially for someone doing it for the first time.

The beneficiaries of the will can also provide added pressure to the procedure given that it is highly likely there will be personal connections between themselves and the executor. Added disagreements, disputes and emotional reactions that a personal connection can bring will prolong and complicate the entire process further.

The hidden risks of DIY probate - Continued

The cost of getting it wrong

Realistically, attempting to take on probate yourself comes with great risk. What may appear to be a quick save could result in you overlooking something critical, making an error or simply not following the correct procedure that could be of great personal expense.

How Compass can help…

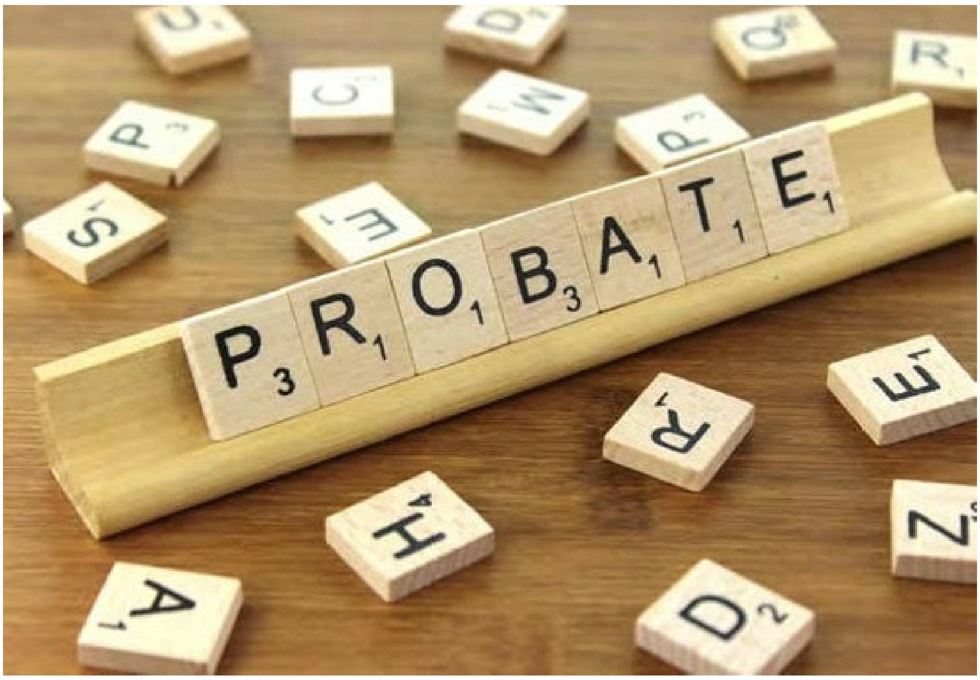
As experts in probate, Compass Accountants provides a service that ensures the procedure is executed correctly, whilst saving you valuable time. Compass Accountants is one of only a small number of accountancy firms licensed to carry out probate services by ICAEW (The Institute of Chartered Accountants in England and Wales), and one of even fewer in Fareham and Portsmouth.

As accountants, we are fully qualified and highly experienced in dealing with all aspects of taxation, legislation, assets, liabilities, preparation of accounts and estate planning, and so we consider ourselves to be in the perfect position to assist with probate services.

Up until December 2014, the provision of Probate Services was limited to solicitors, who have traditionally charged a percentage of the value of the estate. We work on a fixed fee basis and can offer a real value for money alternative.

At Compass Accountants, we will be able to guide you through the complications of inheritance tax, income tax and capital taxes, ensuring that the amount of tax that needs to be paid from the estate in minimised. Furthermore, we will work with you (and any of the beneficiaries) to set in place plans to minimise their future tax burdens.

If you are interested in booking an appointment for a free consultation for probate services- or would simply like to ask us a question, please feel free to call us on: 01329 844145.



Tax Diary
March/April 2020

1 March 2020 - Due date for Corporation Tax due for the year ended 31 May 2019.

2 March 2020 – Self assessment tax for 2019/19 paid after this date will incur a 5% surcharge.

19 March 2020 - PAYE and NIC deductions due for month ended 5 March 2020. (If you pay your tax electronically the due date is 22 March 2020)

19 March 2020 - Filing deadline for the CIS300 monthly return for the month ended 5 March 2020.

19 March 2020 - CIS tax deducted for the month ended 5 March 2020 is payable by today.

1 April 2020 - Due date for Corporation Tax due for the year ended 30 June 2019.

19 April 2020 - PAYE and NIC deductions due for month ended 5 April 2020. (If you pay your tax electronically the due date is 22 April 2020)

19 April 2020 - Filing deadline for the CIS300 monthly return for the month ended 5 April 2020.

19 April 2020 - CIS tax deducted for the month ended 5 April 2020 is payable by today.

30 April 2020 – 2018-19 tax returns filed after this date will be subject to an additional £10 per day late filing penalty.

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
EMAIL: contact@compassaccountants.co.uk