



COMPASS

ACCOUNTANTS

TAX ANGLES FOR PROACTIVE PLANNING

Newsletter - November 2018

In this month's edition...

- Claim a deduction for pre-trading expenses
- Tax-free Christmas parties
- Give away £3,000 IHT-free each year
- Pass on your house free of IHT
- Take advantage of the Annual Investment Allowance
- Client Focus

Claim a deduction for pre-trading expenses

As a general rule, a deduction is allowed for expenses that are incurred wholly and exclusively for the purpose of the trade. Thus, for the deduction to be available, the business must have started trading. However, most businesses will incur expenses in setting up the business. These may include rents and other premises costs, marketing and advertising costs, the purchase of office supplies and stationery, and such like. These costs will be incurred before the business starts to trade rather than when the business is trading; they are incurred to put the business in position to trade, rather than for the purposes of the trade.

Luckily, help is at hand and the tax legislation specifically allows relief for pre-trading expenses, as long as certain conditions are met. Relief is available for both income tax and corporation tax purposes, providing a deduction regardless of whether the trader operates as a sole trader or via a limited company.

The relief is available for:

- expenditure which is incurred within a period of seven years prior to the commencement of the trade, profession or vocation; and
- which is not allowable as a deduction, but which would have been allowable had the expenditure been incurred after the trade had commenced.

Applying the 'wholly and exclusively' rule

The 'wholly and exclusively' rule applies equally to determine whether expenses which are incurred prior to the commencement of trade are deductible under the pre-trading expenses rule, as it does to determine the deductibility of expenses incurred while trading. Only those pre-trading expenses which are incurred wholly and exclusively for the purposes of the trade can be deducted under the pre-trading expenses rules.

How is relief given?

Relief is given by treating the qualifying expenses incurred in the seven years prior to the commencement of the trade as if they were incurred on the first day of trading. Consequently, they are deductible in computing the profits of the first accounting period.

Trap

The purchase of trading stock is not deductible as a pre-trading expense; it is deductible in computing profits once the trade as commenced.

Capital v revenue

Where the accruals basis is used, relief is only given for pre-trading expenses if they are revenue in nature, as is the case where the expenses are incurred once the trade has commenced. If the trader has opted to use the cash basis, capital expenses may also be deducted where these would be deductible under the cash basis rules.

Example

Dave starts trading as sports therapist on 1 November 2018. He spends six months setting up the business, acquiring premises and preparing to trade. He incurs £2,000 on rent, and £800 on marketing the business. The expenses are treated as incurred on 1 November 2018 and are deducted in computing the profits of his first accounting period.

Tax-free Christmas parties

Although the tax legislation contains an exemption to prevent employees from suffering a benefit-in-kind tax charge on the staff Christmas party, the exemption is limited in scope and application. It is unwise to assume that there will be no tax to pay – without proper planning, an unwanted tax charge may accompany the post-party hangover.

Nature of the exemption

The exemption applies to an annual party or similar function which is provided to the employer's employees generally, or to those at a particular location. Where only one annual party or similar function is provided in the tax year, no income tax liability arises as long as the cost per head figure does not exceed £150. Where more than one such function is provided in the tax year, the exemption applies if the cost per head of the exempt party or parties does not exceed £150 in aggregate.



Tax-free Christmas parties

Trap 1 – annual functions only

The first trap is that the exemption applies only to annual functions – i.e. functions that are held each year. Thus, the staff Christmas party or annual summer barbecue may qualify, but a one-off event, such as party to celebrate the company's 10-year anniversary, will not. Where the function is not an annual function, a benefit in kind charge may arise. However, if the cost is less than £50 per employee, it may fall within the trivial benefits exemption.

Trap 2 – all employee condition

The exemption only applies if the party is open to all employees, or to those at a particular location. So, for example, if the company has sites in Birmingham and Manchester, an annual Christmas party for the Manchester-based employees would be permitted under the terms of the exemption, a party to which only directors and senior managers were invited would not.

Trap 3 – exemption capped at £150 per head

The exemption is limited to £150 per head. There are several points to note as regards to this condition. The first is that the cap is applied per head, not per employee. The cost per head figure is found by dividing the total cost of providing the function by the number of people attending the function – employees and guests. The total cost of the function includes not only the expenses of providing the function itself, but also the cost of any transport and accommodation which may also be provided. The cost is inclusive of VAT – even if this is subsequently reclaimed.

Thus if the total cost of a function is £5,440 and it is attended by 38 employees and 30 guests at a total of 68 people - the cost per head figure is £80 per head ($£5,440 \div 68$).

The second point to note is that the exemption is not a tax-free allowance – if the cost per head figure is more than £150, the whole amount is taxed, not just the excess over £150. Where, say, the cost per head is £175 and an employee brings a guest, the amount of the benefit on which the employee is taxed is £350 (employee plus their guest).

Where there is more than one qualifying function, the exemption can be used to best effect. So, if an employee attends three functions with cost per head figures of £80, £60 and £65, best use may be to use the exemption for the functions costing £80 and £65 per head. The remaining £5 is lost as it cannot be set against the cost of the £60 per head function.

Tip

Remember to consider the impact of guests – in the above example, if the £65 function was for employees only but the £60 function was for employees and guests, it would be better to use the exemption for the £80 and £60 functions, leaving the £65 function in charge. If the £60 function was left in charge, the cash equivalent of the benefit would be £120 for the employee and guest – which is more than £65. Any tax liability could potentially be met by the employer via inclusion in a PAYE Settlement Agreement.

Give away £3,000 IHT-free each year

There are various exemptions for inheritance tax purposes which enable a person to make tax-free gifts. One of the more useful is the annual exemption.

Nature of the exemption

The annual exemption is set at £3,000. The exemption allows an individual to make gifts of up to £3,000 each tax year without them being included in the transferor's estates.

Gifts covered by the exemption do not count as potentially exempt transfers (PETs) – there is no requirement for the transferor to live a further seven years. Gifts covered by the annual exemption are exempt, even if the transferor dies the next day.

The annual exemption applies to:

- lifetime transfers by individuals;
- the lifetime termination of an interest in possession in settled property; and
- transfers by close companies.

Gifts totalling less than £3,000

If an individual makes gifts in a year which do not exceed the amount of the annual exemption, the gift is tax-free. To the extent that the exemption has not been fully utilised, the excess can be carried forward – but only for one tax year.

Example

In 2017/18, Florence sold some shares and made a cash gift of £1,000 to each of her two granddaughters.

The gifts are covered in full by her annual exemption, using up £2,000 of the exemption. The balance of £1,000 is carried forward to 2018/19.

In 2018/19 Florence makes a further gift of £2,000 each to her granddaughters. Although the gifts total £4,000 in 2018/19, they are exempt in full, being covered by the annual exemption for 2018/19 of £3,000 and the unused exemption of £1,000 from 2017/18 which has been carried forward to 2018/19.

Gifts exceeding the annual exemption

If the value of the gifts in the tax year exceeds the available annual exemption (£3,000 plus any unused exemption brought forward from the previous tax year) and other exemptions are not available, the gifts are exempt up to the value of the available exemption. If the balance is a gift by an individual, it will be a PET; otherwise it may be an immediately chargeable lifetime transfer.

Example

Harry makes a gift from capital of £10,000 in 2018/19 to his son Paul. It is the only gift he makes in the tax year. In 2017/18 he used his annual exemption in full.

The first £3,000 of the gift is covered by the annual exemption. The remaining £7,000 is a PET.

Multiple gifts

Where a transferor makes multiple gifts in a tax year, the annual exemption is applied to the gifts in the order in which they are made.

Example

In May 2018, Barbara gives £2,000 to her daughter Julie; in October 2018, she gives £2,000 to her daughter Jane and in December 2018 she gives £2,000 to her son James.

In 2017/18, she fully utilised her annual exemption. The gift to Julie is fully exempt, falling entirely within the annual exemption.

The first £1,000 of the gift to Jane is exempt, utilising the remaining £1,000 of the annual exemption. The remaining £1,000 is a PET. The gift to James is a PET.

Pass on your house free of IHT

The introduction of the residence nil rate band (RNRB) opens up the possibility of leaving the family home to successive generations without triggering an inheritance tax charge. It is available for deaths on or after 6 April 2017.

The RNRB is an additional nil rate band that is available where a qualifying residence is passed on death to a direct descendant. The RNRB is:

- £100,000 for 2017/18
- £125,000 for 2018/19
- £150,000 for 2019/20
- £175,000 for 2020/21

From 2021/22 onwards it will be increased each year in line with the Consumer Prices Index (CPI).

Estates worth more than £2 million

Where the net value of the estate is more than £2 million, the RNRB is reduced at a rate of £1 for every £2 by which the value of the estate exceeds £2 million. Thus, for 2018/19, the RNRB is not available where the net estate exceeds £2,350,000.

Interaction with existing nil rate band

The RNRB is available in addition to the normal nil rate band of £325,000. However, it can only shelter a residence that is passed on death to a direct descendant. The value of the RNRB is capped at the net value of the residential property (i.e. after deducting liabilities such as a mortgage) left to direct descendants where this is less than the maximum for the year, as set out above.

Transfer to spouse

The spouses' exemption allows property to be left to a spouse or civil partner without triggering an inheritance tax charge. However, to ensure that the nil rate band is not lost, the proportion unused on the death of the first spouse or civil partner may be transferred to the surviving spouse or civil partner and used on their death. The RNRB band operates in the same way and any unused proportion is transferred to the surviving spouse or civil partner.

The transfer is available even if the first death was prior to 6 April 2017 as long as the surviving spouse or civil partner dies after that date.

Qualifying residence

The RNRB only applies where the residence that is passed on is a qualifying residence. This must be a residential property – a property such as a buy-to-let property in which the deceased has never lived does not qualify. Where there is more than one qualifying residence, the personal representative can nominate which one qualifies.

Direct descendant

The RNRB is only available if the residence is left to a direct descendant. This includes a child (including step, adopted and foster children) and their lineal descendants.

Downsizing

Where the deceased downsized after 8 July 2015 or ceased to own a residence after that date, the funds relating to the former residence can still qualify for the RNRB if passed to a direct descendant.

Example

Ida and Edward have lived in their family home for many years. On her death in 2015, Ida left her whole estate to Edward. On his death in June 2018, he left his estate worth £850,000 equally between his two sons. The estate included the family home with a net value of £600,000.

Edward's estate benefits from the nil rate band of £325,000 and 100% of Ida's nil rate band – a further £325,000.

He is also able to benefit from the RNRB (£125,000), plus 100% of Ida's RNRB (a further £125,000) as he leaves a qualifying residence to direct descendants. As the net value of the residence is worth more than £250,000, the available RNRB is £250,000.

Edward's total nil rate band (including the RNRB) is £900,000 ((2 x £325,000) + (2 x £125,000)). As the value of his estate is less than this, it is free from inheritance tax.



Take advantage of the Annual Investment Allowance

The annual investment allowance (AIA) allows businesses to obtain an immediate deduction against profits for capital expenditure up to the limit of the allowance.

Where a business prepares accounts using the more traditional accruals basis, they are not allowed to deduct capital expenditure in computing profits; instead relief for capital expenditure is given under the capital allowances system, whether in the form of the AIA, a first-year allowance or a writing down allowance.

Where a business prepares accounts using the cash basis, different rules apply to capital expenditure. Under the cash basis, capital expenditure can be deducted in computing profits unless the expenditure is of a type where such a deduction is prohibited, for example, as is the case for land and cars. Capital allowances are not in point (except for cars), and the annual investment allowance is not available.

What expenditure qualified for the AIA?

The AIA is available on most items of plant and machinery, the main exception being cars. The AIA is likewise not available on items owned for another reason before they were used in the business or on items given to the proprietor or the business.

The AIA can only be claimed for the period in which the item of plant or machinery was purchased. The date of purchase is when the contract is signed, if the payment is due within four months or, where payment is due more than four months later, the date that the payment is due. The claim is made in the company or self-assessment tax return, as appropriate.

How much is the AIA?

The allowance is set at £200,000 for 12-month periods. The allowance is reduced proportionately for accounting periods of less than 12 months (so, if the accounting period is nine months, the AIA limit for that period is £150,000 ($9/12 \times £200,000$)). It was announced in the recent budget that this allowance will increase to £1,000,000 for the two years from 1st January 2019 to 31st December 2020..

If qualifying expenditure in the period is less than the AIA for that period, the AIA can be claimed for the full amount of the expenditure. However, if qualifying capital expenditure in the period is more than the AIA for that period, the AIA can only be claimed up to the amount of the allowance, with relief for the balance of the expenditure being given by means of writing down allowances.

Example 1

Harry buys three vans costing £20,000 each in the year to 30 September 2018. The total expenditure of £60,000 is less than the AIA available for the period, so he is able to claim the AIA for the full amount of the expenditure.

Example 2

George buys new machinery costing £300,000 in the year to 31 October 2018. The expenditure exceeds the available AIA for the period of £200,000. He is able to claim the AIA on the first £200,000 of the expenditure. Relief for the remaining £100,000 is given by way of writing down allowances.

How is relief given?

Relief is given as a deduction in computing profits for the period. Thus, claiming the AIA provides immediate 100% relief for capital expenditure.

What happens when the item is sold?

If the item is sold, the proceeds are added to the relevant pool. This may trigger a balancing charge.

Do we have to claim the AIA?

No – a claim is not mandatory. It will not always be beneficial to claim the AIA, for example if profits are insufficient or the item is likely to be sold after a short period triggering a balancing charge; it may be preferable to claim writing down allowances instead. The claim can be tailored to the business' circumstances.

Client Focus- Laura Bowyer- Employment Matters

This month, we speak to Laura Bowyer, Compass client, specialist in employment law, HR & mediation and owner of the consultancy firm- Employment Matters.

Eight years ago Laura Bowyer made the bold decision, following her employment with a city based law firm, to start her own firm in Warsash, Southampton. Since making that decision, she has built a strong clientele and the foundations of a business she is proud to be at the helm of. Having worked in employment law for over 25 years now, Laura has honed her skills and expertise to be able to offer a bespoke service to both businesses and individuals, allowing them access to her expertise in a way that best suits them.

"I aim to offer my services either on a retained or on an ad-hoc basis," explains Laura. "Which allows businesses to access guidance on any HR or employment law issues, as and when they need it. This removes the huge expense of hiring a lawyer or employing an HR Director/Manager."

"For any business- even if they have as little as one employee – HR and employment law issues are a headache, especially if you aren't familiar with these areas. For my clients, I am always at the end of the telephone to help. My clients often contact me to just run things past me, get my opinions on the best way to do something. I also do a lot of contracts, review documents, update contracts, deal with discipline, grievances and performance reviews."

The service Laura provides isn't limited to companies of any particular size, as she tailors her packages specifically to each individual client, her smallest client being an employer of one staff member, her largest being a retail business chain that employs over 80.

"Of course, the more employees that a business has, the more issues arise," says Laura. "I am what you would call a one-stop-shop and I'm therefore available to do anything from issuing a dismissal, right up to representing a company at tribunal and dealing with the case in front of a judge. I am often required to handle continued absences and manage redundancies, restructures and bullying and harassment investigations. When a business owner doesn't have the time- or when they don't know how to deal with such things- I can be there to develop a strategy."

Earlier this year Laura had met Compass Director Stuart Lawrance at an event during a time when she was considering moving on from the accountants she currently employed.

"The former accountant I had worked with had presented some unexpected bills from HMRC, and those last-minute surprises were something I wanted to avoid. I met Stuart at a networking event, and we were sat next to each other – so I mentioned this and he explained that Compass always made sure clients knew what they were going to pay well in advance.

I recently appointed Compass and I am so pleased I did. They have turned everything around and they work so efficiently and quickly. Also- I was so surprised when Stuart told me that he had originally overestimated the original quote he gave me and therefore would be charging me less. It was so refreshing to meet such an honest and trustworthy company. I have been really pleased with their service. My husband is a qualified gas engineer, because of the relationship I have developed with Compass, I have recommended that he goes to see Stuart. I also have a friend running their own business that is having a delicate time with their current accountant and I have said *don't waste any time - go and see Compass now!*"

If you are interested in the HR and Employment Law services that Laura offers, or you have a question for her you can visit her website at : www.employ-matters.co.uk

Or email her at laura@employ-matters.co.uk or call her on 07971224791.



Tax Diary November/December 2018



1 November 2018 Due date for Corporation Tax for years ended 31 January 2018.

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

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

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

1 December 2018 Due date for Corporation Tax for years ended 28 February 2018.

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

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

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

30 December 2018 Deadline for filing 2017-18 Self-Assessment online to include claim for under payments (under £3,000) to be collected via tax code in 2019.

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.



Contact us:

TEL: 01329 844145 or 02393 233196

EMAIL: contact@compassaccountants.co.uk

Compass Accountants

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