



COMPASS

ACCOUNTANTS

TAX ANGLES FOR PROACTIVE PLANNING

Newsletter - November 2019

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Beware of triggering an IHT bill on Christmas gifts

When deciding what to give as Christmas gifts, the possibility of triggering an unintended inheritance tax liability is not one that immediately springs to mind. However, there are traps that may catch the unwary.

Income or capital

When making a gift, it is important to ascertain whether the gift is being made out of income or from capital. There is an inheritance tax exemption for normal expenditure from income. To qualify, the gift must be made regularly and only from surplus income. It is important that after making the gift you have sufficient income left to maintain your usual lifestyle. To avoid unwanted questions, it is a good idea to set up a regular pattern of giving and keep records to show that the gifts were made from income.

A gift that is made from capital – for example, from the proceeds from the sale of a property or a gift of a valuable antique – will reduce the value of the estate. Unless the gift falls within the ambit of another exemption, the gift will be a potentially exempt transfer (PET) and will be taken into account in working out the inheritance tax due on the estate if you die within seven years of making the gift.

Gifts to spouses and civil partners

The inter-spouse exemption protects gifts between spouses and civil partners. Consequently, gifts of any value can be given to a spouse or civil partner without worrying about the inheritance tax implications.

Annual allowance

Everyone has an annual allowance for inheritance tax purposes of £3,000. The annual allowance enables you to give away £3,000 every year in assets or cash, in addition to gifts covered by other exemptions, without it being added to the value of your estate.

You can also carry forward the annual exemption to the following year if it is not used, so if you did not use it in the last tax year, you can make gifts of up to £6,000 this year without having to worry about inheritance tax. However, any unused allowance can only be carried forward to the following tax year, after which it is lost.

Small gifts

The small gifts exemption enables you to make gifts of up to £250 a year to as many people as you like without having to keep a tally for inheritance tax purposes. However, the same person cannot benefit from a small gift of £250 in addition to the annual gifts allowance.

Wedding gifts

If a family wedding is on the horizon, you can take advantage of the wedding gifts exemption to make further gifts. To qualify, the gifts must be made before the wedding not afterwards. The exempt amounts are set at £5,000 for gifts to a child, £2,500 for gifts to a grandchild or great-grandchild and at £1,000 for a gift to another relative.

Self-employed – How to calculate your payments on account

The deadline for filing the self-assessment tax return for 2018/19 is 31 January 2020. This is also the date by which any outstanding tax for 2018/19 must be paid and, where payments need to be made on account, the date by which the first payment on account of the 2019/20 liability must be made.

What is a payment on account?

As the name suggests, a payment on account is an advance payment towards a taxpayer's tax and Class 4 National Insurance bill. Where payments on account are due, the tax is payable in two instalments on 31 January in the tax year and on 31 July after the tax year rather than in full in a single instalment of 31 January after the tax year.

As the payments on account are based on the previous year's liability, it is not an exact science – there may be more tax to pay or the taxpayer may have paid too much. Any balancing payment must be made by 31 January after the end of the tax year. If the taxpayer has paid too much, the excess will normally be set against the next year's payments on account or refunded if none are due.

When must payments on account be made?

Payments on account must be made where tax and Class 4 National Insurance for the previous tax year was £1,000 or more, unless at least 80% of the tax owed has been deducted at source, for example under PAYE.

Payments on account are not required when the tax and Class 4 National Insurance bill for the previous year was less than £1,000.

Calculating the payments on account

Each payment on account is 50% of the previous year's tax and Class 4 National Insurance liability.

Class 2 National Insurance contributions are not taken into account in calculating the payments on account and must be paid in full by 31 January after the end of the tax year.

Example

Richard is a sole trader. In 2018/19 his profits from self-employment were £30,000. He has no other income.

His income tax liability for 2018/19 is £3,630 (20% (£30,000 - £11,850)) and his Class 4 National Insurance liability is £1,941.84 (9% (£30,000 - £8,424)).

His combined tax and Class 4 National Insurance liability is thus £5,771.84.

As this is more than £1,000, he must make payments on account of the 2019/20 tax year of £2,785.92 on 1 January 2020 and 31 July 2020. Each payment is 50% of the previous year's liability of £5,771.84. If the liability for 2019/20 is more than £5,771.84, the balance must be paid by 31 January 2021, together with the Class 2 National Insurance for 2019/20.

Beware fluctuating years

Where the tax and Class 4 liability is under £1,000 one year but not the next, the payments can fluctuate widely – this may hit the taxpayer hard.

Example

Tim has a tax and Class 4 National Insurance liability of £900 in 2017/18. As a result, he is not required to make payments on account for 2018/19. However, 2018/19 is a good year and his tax and National Insurance liability is £4,000. As payments on account were not made, the amount is due in full by 31 January 2020. Also, because it is more than £1,000, he must make payments on account for 2019/20.

As a result, he has to pay £6,000 on 31 January 2019 – the full liability for 2018/19 (£4,000) and the first payment on account of £2,000 (50% of £4,000) for 2019/20. The second payment on account for 2019/20 of £2,000 is due by 31 July 2020.

Reduce payments on account

If the taxpayer knows that income in the current year will be less than the previous year, they can ask HMRC to reduce the payments on account. However, interest is charged on the shortfall if the payments are reduced below the level they should be.

Zero charge for zero emission cars

From 6 April 2020, the way in which carbon dioxide emissions for cars are measured is changing – moving from the New European Driving Cycle (NEDC) (used for cars registered prior to 6 April 2020) to the Worldwide Light Testing Procedure (WLTP) for cars registered on or after 6 April 2020.

For an introductory period, the appropriate percentages for cars registered on or after 6 April 2020 are reduced – being two percentage points lower than cars with the same CO2 emissions registered prior to 6 April 2020 for 2020/21 and one percentage point lower for 2021/22. From 2022/23 the appropriate percentages are aligned regardless of which method is used to determine the emissions.

Zero emission cars

As part of the transition, the appropriate percentage for zero emission cars is reduced to 0% for 2020/21 and to 1% for 2021/22. This applies regardless of when the car was registered.

The charge was originally set at 2% for 2020/21 and 2021/22, and will revert to this level from 2022/23.

Impact

Electric company car drivers were already set to enjoy a tax reduction. The appropriate percentage for 2019/20 is 16% and was due to fall to 2% from 6 April 2020. However, the further reduction to 0% means that those who have opted for an electric company car can enjoy the benefit tax-free in 2020/21. Their employers will also be relieved of the associated Class 1A National Insurance charge.

Case study

Kim has an electric company car throughout 2019/20, 2020/21 and 2021/22. The car has a list price of £32,000. Kim is a higher rate taxpayer.

In 2019/20, Kim is taxed on 16% of the list price – a taxable benefit of £5,120. As a higher rate taxpayer, the tax hit is £2,048 (40% of £5,120). Her employer must also pay Class 1 National Insurance of 13.8% on the taxable amount (£706.56).

In 2020/21, the appropriate percentage is 0% so there is no tax or Class 1A National Insurance to pay. This is a significant reduction compared to 2019/20.

In 2021/22, the charge is 1% of the list price, equal to £320, on which the tax is £128 (assuming a 40% tax rate) and the Class 1A National Insurance is £44.16.

From 2022/23 the charge is 2% of the list price – equal to £640.

Not quite zero emissions

It is also possible to enjoy a company car tax-free in 2020/21 if it is registered on or after 6 April 2020, has emissions of between 1 and 50g/km (measured under the WLTP) and an electric range of at least 130 miles.

Go electric

The benefits of choosing electric cars from a tax perspective, as well as from an environmental one, are significant.



Can we deduct entertaining expenses?

The tax rules on the deductibility of entertaining expenses are harsh and often misunderstood – the fact that the expenditure is incurred for businesses purposes does not make it deductible. Subject to certain limited exceptions, no deduction is allowed for business entertaining and gifts in calculating taxable profits.

What counts as business entertainment?

Business entertainment is the provision of free or subsidised hospitality or entertainment. Hospitality includes the provision of food drink or similar benefits for which no payment is made by the recipient. It also extends to subsidised hospitality whereby the charge made to the recipient does not cover the costs of providing the entertainment or hospitality.

Examples of business entertaining would include taking a supplier to lunch, taking customers to a day at the races, or inviting them to a box at rugby match, and suchlike. The definition is wide.

Exception 1: Entertaining employees

One of the main exceptions to the general rule that entertaining expenses cannot be deducted is in relation to staff entertainment. A deduction is allowed for the cost of entertaining staff, as long as the costs are incurred wholly and exclusively for the purposes of the trade and the entertaining of the staff is not merely incidental to the entertaining of customers. So, for example, a company would be able to deduct the cost of the staff Christmas party in calculating its taxable profits. However, if a company takes customers to Wimbledon, the fact that a number of employees also attended is not enough to guarantee a deduction as the entertaining provided for the employees is incidental to that for customers.

It should be noted that unless an exemption is in point, employees may suffer a benefit in kind tax charge on any entertainment provided.

Exception 2: Normal course of trade

The disallowance does not apply where the business is that of providing hospitality, and as such a deduction is allowed for the costs incurred in providing that hospitality as long as they are incurred wholly and exclusively for the purposes of the business. Businesses such as restaurants and events management companies would fall into this category.

Exception 3: Contractual obligation to provide entertainment

Where entertainment is provided under a contractual obligation, this is not treated as business entertainment and a deduction is allowed for the cost. A common example would be where hospitality is provided as part of a package. However, the business should be able to demonstrate that they have received a full return for the entertainment provided.

Exception 4: Small gifts carrying an advert

The provision of business gifts is treated as business entertaining with the result that a deduction for the costs is not generally allowed. However, there is an exception for gifts costing not more than £50 per year per recipient which bear a conspicuous advert for the business. An example of a deductible gift would be a diary or a water bottle featuring an advert for the business.

Remember...

Just because entertaining is incurred for business purposes does not mean that it is allowable – business entertaining needs to be added back in the corporation tax computation.



Directors' loans – Beware of 'bed and breakfasting'

It can make sense financially for directors of personal and family companies to borrow money from the company rather than from a commercial lender. Depending on when in the financial year the loan is taken out, it is possible to borrow up to £10,000 for up to 21 months without any tax consequences. However, if the loan remains outstanding beyond a certain point, tax charges will apply.

Company tax charge

In the event that a loan made to a director of a close company in an accounting period remains outstanding on the date when the corporation tax for that period is due, the company must pay a tax charge ('section 455 tax') on the outstanding value of the loan. The trigger date for the charge is the corporation tax due date of nine months and one day after the end of the accounting period. The amount of section 455 tax is 32.5% of loan remaining outstanding on the trigger date.

Traps to avoid

In days of old, it was relatively simple to prevent a section 455 charge from applying by clearing the loan balance just before the trigger date and, if the director still needed the loan, re-borrowing the funds shortly after the trigger date (bed and breakfasting). However, anti-avoidance provisions mean that as a strategy this is no longer effective.

Trap 1 – The 30-day rule

The 30-day rule comes into play where, within a period of 30 days of making a repayment of £5,000 or more, the director re-borrows money from the company. The rule effectively renders the repayment in-effective up to the level of the funds that are re-borrowed. Section 455 tax is charged on the lower of the amount repaid and the funds borrowed within a 30-day window.

Example

John is a director of his personal company J Ltd. The company prepares accounts to 31 January each year. In May 2018, John borrowed £8,000 from the company. On 28 October 2019, he repays the loan with money lent to him by his wife. On 7 November 2019, he re-borrows £7,000 from the company to enable him to pay his wife back. He does not make any further borrowings in November 2019.

Corporation tax for the year to 31 January 2019 is due on 1 November 2019. Although the director's loan is not outstanding on that date, the 30-day rule bites and only £1,000 of the repayment made on 28 October 2019 is effective -- £7,000 of the £8,000 paid back is re-borrowed within 30 days. Consequently, the section 455 charge applies to £7,000 – the lower of the repayment and the funds borrowed within 30-days of the repayment – and the company must pay section 455 tax of £2,275 (32.5% of £7,000).

Avoiding the trap

The 30-day rule can be avoided if the company pays the director a dividend, bonus or any other payment that's taxable and this is used to repay part or all of a loan. In this situation, it's OK to take another loan from the company within 30 days without the anti-avoidance rule being triggered. Keeping repayments and re-borrowings below £5,000 will also prevent the 30-day rule from biting.

Trap 2 – Intentions and arrangements rule

The 'intention and arrangements' rule applies where the balance of the loan outstanding immediately before the repayment is at least £15,000, and at the time a loan repayment is made there are arrangements, or an intention, to subsequently borrow £5,000.

This rule applies even where the new borrowing is outside 30 days. The rule bites if the repayment is made with the intention of redrawing at least £5,000 of the payment, irrespective of when this is done. Again, the rule does not apply to funds extracted by way of a dividend or bonus as these are within the charge to income tax.

Plan repayments carefully

Where looking to repay loans to prevent a section 455 charge from arising, these should be planned carefully to avoid falling foul of the traps.



Introducing - The S.S Shieldhall and Chief Engineer, Graham Mackenzie

The Steamship Shieldhall is believed to be the largest working steamship, owned and operated entirely by unpaid volunteers, in Northern Europe and has quite an extraordinary past. Much like a floating museum or time capsule, the ship is built on the classical lines of a 1920s steamer with a traditional wheelhouse. The machinery on board is also very similar, (but on a much smaller scale), to that carried on the ill-fated Titanic.

She is moored in Southampton and now functions under a busy programme of summer excursions and events and is also available as a venue that can be hired throughout the year. Shieldhall is maintained and operated entirely by a dedicated team of volunteers, but as a working ship, she has had more than one job in her past.

When she was first laid down in 1955, Shieldhall was operated by Glasgow Corporation to transport treated sewage sludge down the river Clyde to be released at sea.

During the summer months, these excursions would welcome organised parties of up to 80 passengers. However, after many years of faithful service on the Clyde, Shieldhall's work came to an end and she was eventually purchased by the Southern Water Authority in 1977.

Then, in 1985, a preservation society was formed and Shieldhall was purchased from Southern Water in 1988, for £20,000.

"After it was purchased, the ship was restored to be able to cater for the maximum amount of passengers- as it was when originally designed," said Shieldhall's Chief Engineer, Graham Mackenzie. "Then in 1991 it became operational for passengers once again." Shieldhall now functions as a part of the National Historic Fleet and is widely considered as an operational museum.



Introducing - The S.S Shieldhall and Chief Engineer, Graham Mackenzie - Continued

“This year is important for us as the Shieldhall will enjoy her busiest ever public sailing programme with some 26 cruises.” Adds Graham. “These excursions are comprised of a mixture of 2hr, 3hr, 4hr, ½ day and full day sailings. As well as summer cruises, we also hire Shieldhall out for events and corporate functions, especially during the wintertime. We also offer a wide range of courses for all ages, from youth training days to steamship experience days.

“We don’t receive money or funds for the the day to day running of the ship and are without a guaranteed income stream so, much like a business we rely on bookings.”

However, the popularity of the excursions has risen since the society developed its website and enabled passengers to purchase tickets to cruises online.

“Being able to book online has been incredible for us. In around three years, our passenger numbers have doubled. Also, it has allowed us to broaden our membership. We now have members now from as far as New Zealand.” Adds Graham. “We also have passenger bookings from all over the world. Recently someone came from Texas on the Queen Mary 2 to Southampton and went out on Shieldhall for the day whilst visiting.”

One of the biggest challenges for the society is keeping the ship running due to the costs of operating and maintaining the ship. “You have to remember; she was withdrawn twice as she became uneconomical,” said Graham. “So, the cost of running and dry docking for maintenance can amount to very high costs. Then there’s the cost of fuel- which amounts to around £350 an hour just to run the ship.”

Recruiting volunteers is also a challenge- but the society now has between 60 and 70 people that help with deck and engine room maintenance, passenger care, hospitality, shore crew, rope handlers and more.”

“We are hoping to become fully registered as a charity very soon, rather than an exempt charity as we are today, which will allow us to apply for more funding and grants- and Compass have recently been advising us on how to best make that transition.”

If you would be interested in visiting SS Shieldhall, or would like to volunteer, go to the website www.ss-shieldhall.co.uk for more information and a listing of 2020’s summer excursions.



Christmas - Guidance for employers.

Before Christmas 2018 HMRC wrote to employers about a temporary relaxation of the deadline for reporting payroll information. What's the position for this year?

Changing paydays. HMRC is planning to update its guidance to employers about paying employees earlier than usual over the Christmas period. As the new guidance won't be available for a while it has published the key details in advance, including information about the new permanent relaxation of the PAYE RTI reporting rules aimed at avoiding the various problems experienced by employers in previous years.

Guidance. HMRC says that where you pay early over the Christmas period on a date other than when required to under your employment contracts, your full payment submission (FPS) should nevertheless reflect the date on which you would normally pay your workers, i.e. the contractual payday, and you must ensure that the FPS is submitted on or before that date.

Example. You intend to pay your employees their December salary on Friday 20 December 2019 but the normal/contractual payroll date is Tuesday 31 December 2019. You should report the payment date on the FPS as 31 December and ensure the submission is sent on or before 31 December. If you pay your employees weekly, or at intervals other than monthly, the same principle applies.

Why the new rules. According to HMRC, the normal/contractual pay date in your RTI reports will help to protect your employees' eligibility for Universal Credit, as reporting the payday as the payment date may affect current and future entitlements.

Regulations unchanged. As an employer, the overriding PAYE reporting obligation for submitting payroll reports isn't affected by the change. The general rule that you must report payments on or before the date you pay one or more employees still applies.

The reporting deadline will again be relaxed. This means that if you pay employees earlier than normal you don't have to send your PAYE RTI report until the usual payroll date. Remember to show that date in your report.



Tax Diary November/December 2019



1 November – Due date for payment of Corporation Tax for period ended 31 January 2019

2 November – Deadline for submitting P46 (Car) for quarter ending 5 October 2019

6 November – Autumn Budget taking place

7 November – Deadline for VAT returns and payments of Accounting Quarter period ending 30 September 2019

19 November – Monthly deadline for postal payments of CIS, NICs and PAYE to HMRC

22 November – Monthly deadline for electronic remittance of CIS, NICs and PAYE to HMRC

1 December – New Advisory Fuel Rates (AFR) for company car users

Due date for payment of Corporation Tax for period ended 28 February 2019

7 December – Deadline for VAT returns and payments of Accounting Quarter period ending 31 October 2019

14 December – Due date for Corporation Tax quarterly instalment for “very large” companies with year end 31 March 2020

19 December – Monthly deadline for postal payments of CIS, NICs and PAYE to HMRC

22 December – Monthly deadline for electronic remittance of CIS, NICs and PAYE to HMRC

30 December – Deadline for online submission of Self Assessment tax returns for tax year ended 5 April 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.



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