TAXANGLES from COMPASS ACCOUNTANTS

A newsletter for proactive planning...

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August 2024 Issue

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When is a child's income taxable on their parent?

Children may have their own income. This may be in the form of savings income on accounts that they hold or, for older children, income from a paper round or a Saturday job. Like adults, children have their own set of allowances, including a personal allowance and savings and dividend allowances. However, anti-avoidance provisions apply to prevent parents effectively using their children's tax-free allowances to reduce the tax that they pay.

Earned income

For tax purposes, the same rules apply to income earned by children as apply to adults. Children have their own personal allowance, and income sheltered by the allowance will be tax-free. Where a child has trading income, for example, selling items on eBay, they too will benefit from the £1,000 trading allowance. However, a child under the age of 16 is not liable to pay National Insurance contributions.

Savings income

Unless it is significant, it is unlikely that a child will need to pay tax on their savings income. The same rules apply as apply to adults, and their savings income will be tax-free where it is sheltered by the savings allowance, the personal allowance and, where available, the savings starting rate band.

The exception to this rule is where the child receives interest of more than £100 on income given to them by a parent. At an interest rate of 5%, this would be the case where the child has received income of £2,000 or more from their parent. Where a child receives interest of more than £100 on money given to them by a parent, the interest is treated as that of the parent rather than of the child, and to the extent that it is not sheltered by the savings allowance or any unused personal allowance, it will be taxed at the parent's marginal rate of tax. The gift from the parent is treated as constituting a settlement. It is important to keep an eye on the interest received – rising interest rates may take the annual interest, previously less than £100, over the £100 limit, triggering the anti-avoidance rules.

This rule does not apply to money given to a child by grandparents, other relatives or friends – the income is taxed as that of the child, regardless of the amount.

Example

Hannah is 11. Her mother Louise inherits some money and puts £10,000 into an account for Hannah. Interest is paid at the rate of 5% per annum – a total of £500 a year. As the interest exceeds £100 a year, it is taxed as Louise's rather than as Hannah's, and if Louise has used up her personal and savings allowances, she will pay tax on it at her marginal rate of tax.

Hamish is also 11. His grandfather downsizes and from the cash released from the sale of his home puts £10,000 in an account for Hamish, on which interest is paid at the rate of 5% per annum, earning Hamish £500 a year. However, in this case, the money is treated as Hamish's and, as it is covered by his

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personal savings allowance, it is tax-free. To overcome the tax trap where the money is given by a parent, consideration could be given to investing in a Junior ISA. Parents or guardians with parental responsibility can open a Junior ISA, but the money in the account belongs to the child. There are two sorts of Junior ISA – a cash ISA and a stocks and shares ISA. A child can only have one of each. Money can be added to the account(s) each year up to the Junior ISA limit, set at £9,000 for 2024/25. The limit applies across both types of account rather than per account. Income earned on money in a Junior ISA is tax-free, as are dividends on stocks and shares in a stocks and shares Junior ISA.

VAT flat rate scheme – Is it for you?

The VAT flat rate scheme is a simple VAT scheme for smaller VAT-registered businesses. Rather than pay the difference between the VAT charged to customers and that incurred on business purchases over to HMRC, traders using the flat rate scheme instead pay a fixed percentage of their VAT-inclusive turnover to HMRC. The percentage depends on the sector in which the business operates and contains an allowance for VAT incurred on purchases, as under the scheme traders cannot deduct this from what they pay. The record-keeping requirements are less onerous too.

Eligibility

The scheme is open to traders who are eligible to be registered for VAT or who are already registered and whose annual turnover excluding VAT is not more than £150,000. The business must not be associated with another business.

Once within the scheme, a trader can remain in it as long as their annual turnover does not exceed £230,000. However, if turnover exceeds this limit temporarily, HMRC may allow the trader to remain in the scheme if they are satisfied that the trader's turnover in the next 12 months will not exceed £191,500.

Traders using another VAT scheme cannot join the flat rate scheme. If a trader leaves the scheme, they cannot rejoin until 12 months have elapsed.

Traders can either join the scheme online when they register for VAT or, if they are already VAT-registered, by completing form VAT600FRS.

The flat rate percentage

The flat rate percentage that is used to determine the VAT payable to HMRC for a quarter depends on the business sector in which the business operates. The percentages can be found on the Gov.uk website at www.gov.uk/vat-flat-rate-scheme/how-much-you-pay. A flat rate percentage of 16.5% applies to businesses that meet the definition of a 'limited-cost business', regardless of the sector in which they operate. This is the case where goods cost less than 2% of turnover or less than £1,000 (where costs are more than 2% of turnover). Money spent on services is not taken into account in working out whether a business is a limited-cost business.

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A business receives a 1% discount on their flat rate percentage for the first year in which they are in the scheme.

Calculating the VAT due

The VAT due to HMRC for the quarter is found by applying the flat rate percentage to the VAT-inclusive turnover for the period.

Example 1

Diana runs a ladies' clothes shop. In the quarter to 31 July 2024 her turnover including VAT is £36,000. Her flat rate percentage is 7.5% (retailing not listed elsewhere). She must therefore pay over VAT of £2,700 to HMRC (£36,000 @ 7.5%).

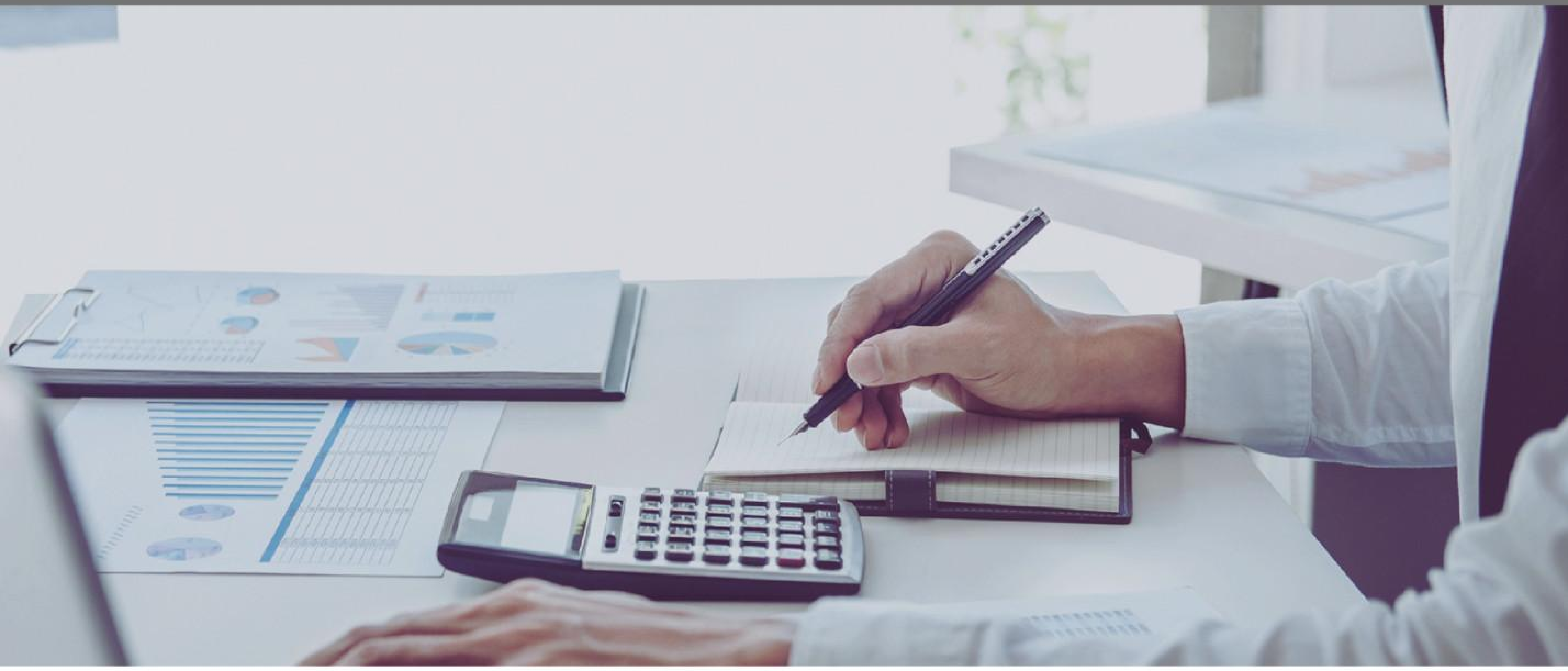
Example 2

Eve is a bookkeeper. In the quarter to 31 July 2024, her VAT-inclusive turnover is £12,000 and her relevant costs are £175. As her costs are less than 2% of her turnover, she is a limited-cost business. The VAT for the quarter is calculated using the flat rate percentage of 16.5% applying to limited-cost businesses rather than that for her sector of 14.5%. She must therefore pay VAT of £1,980 over to HMRC.

Is it worthwhile?

The scheme will save work. Traders using the scheme do not need to keep detailed records of sales and purchases. However, while the flat rate percentages are all lower than 20% (the standard rate of VAT), the scheme will not necessarily save money. Before signing up, it is useful to compare the amount payable under the scheme with that payable under the traditional method to see whether the scheme works for you.

Limited-cost traders can end up worse off. The flat rate percentage for limited-cost traders at 16.5% of VAT-inclusive turnover is equivalent to 19.8% of VAT-exclusive turnover, leaving a very narrow margin to recover VAT on purchases. As services are not taken into account in determining whether a business is a limited-cost business, if the trader incurs a lot of VAT on services, the flat rate scheme may leave them out of pocket. There is no substitute for doing the sums.



Wealthy taxpayers within PAYE – When is a tax return required?

Earlier this year, HMRC wrote to wealthy taxpayers who had not submitted tax returns for 2020/21 and/or 2021/22. A letter was sent where the taxpayer had submitted a return for 2020/21 and 2022/23 but not for 2021/22 or where a return had been submitted for 2019/20 and 2022/23 but not for 2020/21 or 2021/22. Taxpayers who received a letter from HMRC had previously been sent a notice to complete a Self Assessment tax return.

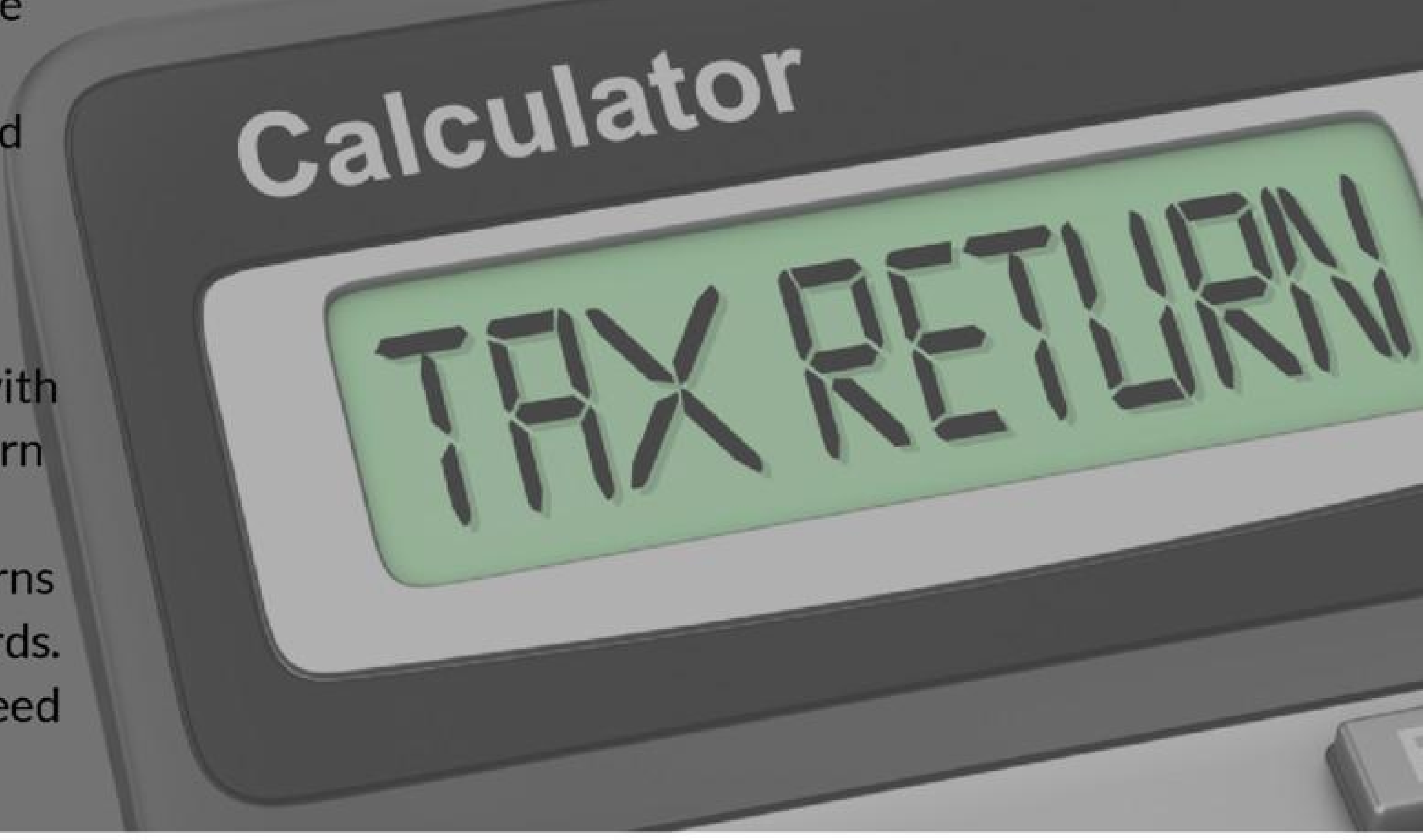
The letter asked taxpayers with outstanding returns for the missing year(s) to submit them by 12 July 2024. Where this has not been done, HMRC will issue a determination of the amount of tax that they think is due based on the information that they hold. They will also charge late filing penalties. However, the taxpayer can appeal against the penalties if they have a reasonable excuse for filing late.

Taxpayers who received a letter but who do not think a return is required should contact HMRC on 03000 516640 or email them at response2@hmrc.gov.uk rather than simply ignoring the letter.

When a return is required

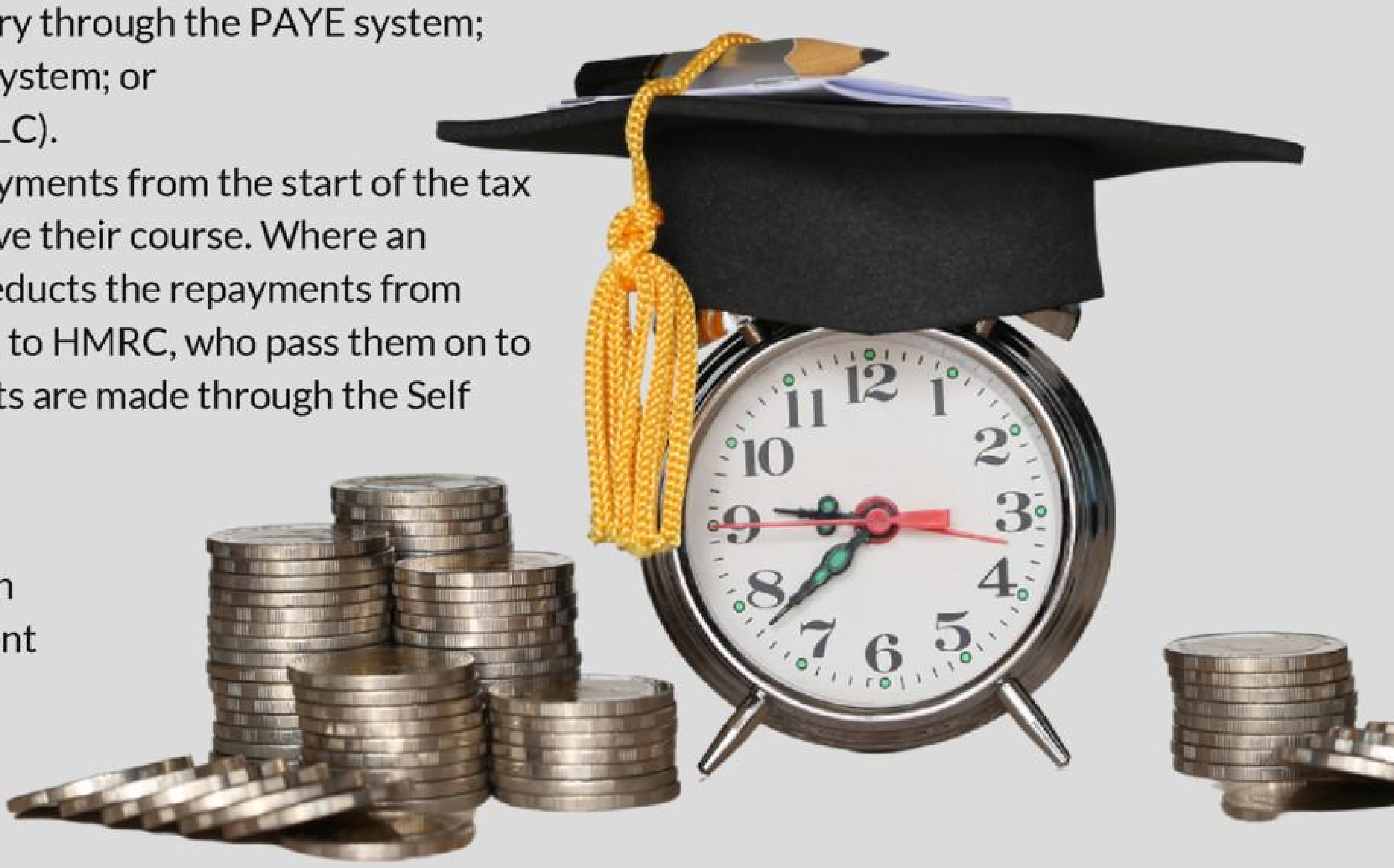
Where a taxpayer is wholly within PAYE, it is understandable that they may not realise that they need to file a return as the tax that they owe should be collected through the PAYE system. However, despite this, HMRC have historically required wealthy taxpayers to submit tax returns, even if they are taxed under PAYE. Presumably, this is because wealthy individuals are more likely to have savings and investment income on which tax may be due.
For 2022/23 and earlier tax years, PAYE taxpayers with income or £100,000 or more needed to file a tax return even if they had no other income to declare. This threshold is increased to £150,000 for 2023/24 returns and abolished completely for 2024/25 returns onwards. However, a wealthy taxpayer within PAYE will still need to file a return if they have other income to declare. This will be the case if they were also self-employed and had trading income in excess of £1,000, they were also a partner in a partnership, they fell within the scope of the High Income Child Benefit Charge, they have chargeable gains to declare, they had rental income in excess of £1,000 to declare or received taxable foreign income.
A tax return may also be required where the taxpayer has savings and investment income to report.

It is important to review this as recent changes may mean that a PAYE taxpayer now has a tax liability on their savings or dividend income for the first time.
The reduction in the additional rate threshold to £125,140 for 2023/24 onwards meant that taxpayers with income of between £125,140 and £150,000 lost their personal savings allowance as the allowance is only available to higher and basic rate taxpayers. Even if the taxpayer remains in the higher rate band, rising interest rates may mean that the interest on their savings now exceeds the personal savings allowance. Similarly, the reduction in the dividend allowance to £1,000 for 2023/24 and to £500 for 2024/25 may mean there is tax to pay on dividends for the first time.
Wealthy taxpayers within PAYE should check whether they need to file a return. If they have received a notice to file and do not think they need to submit a return, they are advised to contact HMRC.



Making student loan repayments through Self Assessment

There are three ways in which former students with student or post-graduate loans can make loan repayments:
·from deduction from their wages or salary through the PAYE system;
·to HMRC through the Self Assessment system; or
·direct to the Student Loans Company (SLC).
Students will normally start making repayments from the start of the tax year after that in which they finish or leave their course. Where an individual is employed, their employer deducts the repayments from their wages or salary and pays them over to HMRC, who pass them on to the SLC. Here, we look at how repayments are made through the Self Assessment system.



Repayment thresholds

Loan repayments are only made where an individual's income exceeds the repayment threshold for the loan that they have.
For 2023/24 and 2024/25, the annual thresholds are as follows:

	Annual Repayment Threshold	
Loan Type	**2023/24**	**2024/25**
Plan 1 -student loan	£22,015	£24,990
Plan 2 -student loan	£27,295	£27,295
Plan 4 -student loan	£27,660	£31,395
Post graduate loan	£21,000	£21,000

For Plan 1, Plan 2 and Plan 4 student loans, repayments are made at the rate of 9% of income in excess of the relevant threshold; for post-graduate loans, repayments are made at the rate of 6% of income in excess of the relevant threshold. The repayments are the same regardless of the repayment method.

Repaying through Self Assessment

Taxpayers who are self-employed or who have another source of income (other than one taxed through PAYE) and who need to complete a tax return will make repayments through the Self Assessment system. Where an individual is employed but also has income which they need to declare on a tax return, for example, from a self-employment, they will make repayments both through PAYE and through Self Assessment. However, any amounts repaid through PAYE will be deducted in determining the amount to be paid through the Self Assessment system.

Unearned income

Unearned income is taken into account in calculating student loan repayments if it exceeds £2,000 in the tax year. This would include income from savings (before deducting the personal savings allowance) or rental income (after deducting the property allowance where relevant). However, if unearned income is less than £2,000, it is ignored in calculating student loan repayments.

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Example

Martha has a job in 2023/24 in which she earns £30,000. She also has profits of £4,000 after deducting the trading allowance from her freelance knitwear business and interest on savings of £800 a year. She has a Plan 2 student loan.
Her earnings from her job in 2023/24 exceed the Plan 2 threshold of £27,295 by £2,705. Her employer deducts student loan repayments of £243 (9% (£30,000 – £27,295)).

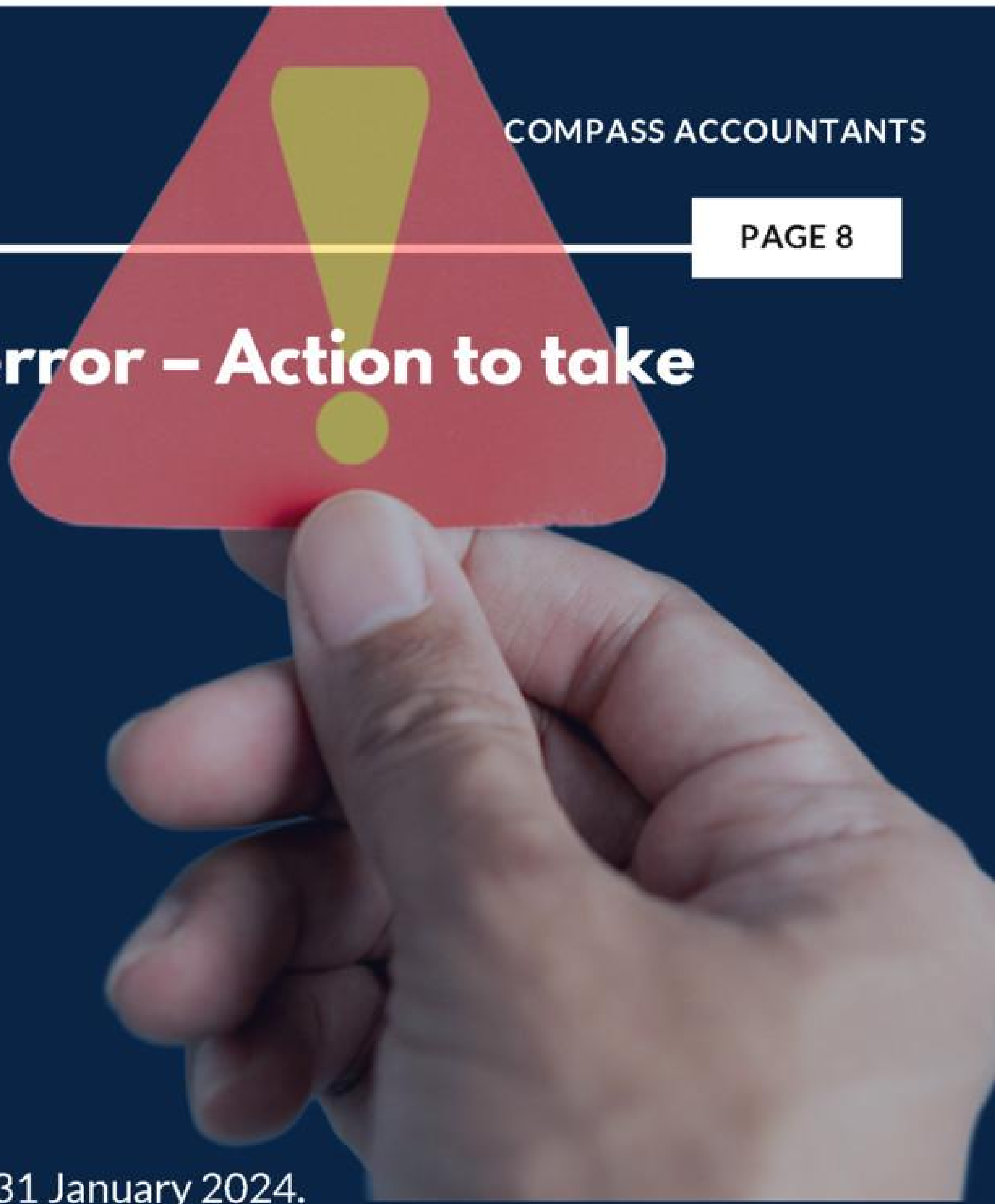
Martha completes her 2023/24 tax return. Her total income for the year is £34,800. However, as her unearned income of £800 is less than the £2,000 threshold, it is ignored in calculating her student loan repayments for the year, and the repayments are calculated by reference to income of £34,000.

Consequently, she is required to pay back £603 (9% (£34,000 – £27,295)). However, she has already paid back £243 through the PAYE system, leaving a balance of £360 to be paid by 31 January 2025 through the Self Assessment system.

Beware payrolled benefits

Last year HMRC were forced to apologise after they miscalculated student loan repayments. The error arose because payrolled benefits were taken into account in calculating the repayments when they should have been ignored.

HMRC wrote to those affected, who were offered the choice of a refund or the option to leave the amount as a loan repayment. While HMRC are now aware of this, it is prudent to check that payrolled benefits have not been taken into account is calculating amounts due.



Class 2 NIC refunds made in error – Action to take

Class 2 National Insurance contributions are flat rate contributions which for 2023/24 and earlier tax years are payable by the self-employed where their profits exceed the relevant trigger threshold. For 2023/24 and 2022/23, the liability to pay Class 2 contributions arose where profits exceeded the lower profits threshold (set at £12,570 for 2023/24). For those years, self-employed earners whose profits were between the small profits threshold (set at £6,725 for 2023/24) and the lower profits threshold were treated as having paid Class 2 National Insurance at a zero rate, giving them a qualifying year for state pension purposes for zero contribution cost. For years prior to 2022/23, self-employed earners whose profits exceeded the small profits threshold were liable to pay Class 2 contributions.

Self-employed earners whose profits from self-employment are below the small profits threshold can opt to pay Class 2 contributions voluntarily to secure a qualifying year. This is a cheaper option than paying voluntary Class 3 contributions. The liability to pay Class 2 contributions was abolished from 2024/25. However, self-employed earners with profits below the small profits threshold remain eligible to pay Class 2 contributions voluntarily.

Collection through Self Assessment

Class 2 National Insurance contributions are collected through the Self Assessment system, as for income tax and Class 4 National Insurance contributions. They are payable by 31 January after the end of the tax year to which they relate. However, unlike Class 4 contributions, they are not taken into account in calculating payments on account.

The collection of Class 2 contributions has not been without problems, and there have been reports of HMRC reversing the Class 2 charge in the Self Assessment calculation because the self-employment has not been recorded correctly on HMRC's National Insurance computer system. Further problems arose in respect of Class 2 contributions paid voluntarily for 2022/23 where the payment was made on or slightly before the due date of 31 January 2024.

Repayment of 2022/23 voluntary contributions

As a result of a delay by HMRC in processing payments, voluntary contributions paid on time for 2022/23 were treated as having been paid late, with HMRC reversing the voluntary Class 2 charge. As a result, the self-employed earner may have received a refund from HMRC. If they have not received a refund, the payment will either be showing as a credit in their Self Assessment account or have been allocated to a different Self Assessment liability. If you are self-employed and you paid Class 2 contributions voluntarily for 2022/23, you can check on the HMRC app to see if the contributions paid for that year are showing on your National Insurance record. If the contributions have been refunded, held as a credit or allocated elsewhere, the year will not be a qualifying year, and this may affect your state pension entitlement. You can call HMRC on 0300 200 3500 for assistance.

The professional bodies have been pressing HMRC to resolve this issue. However, HMRC have now advised that they are unable to do so. The need for individuals to call HMRC for help will place further pressure on HMRC helplines which are already struggling to cope. It is important that individuals check their National Insurance record and state pension forecast regularly so that errors can be rectified before it is too late.

TAX DIARY

AUGUST

- 1 August 2024 – Due date for corporation tax due for the year ended 31 October 2023.
- 19 August 2024 – PAYE and NIC deductions due for month ended 5 August 2024. (If you pay your tax electronically the due date is 22 August 2024)
- 19 August 2024 – Filing deadline for the CIS300 monthly return for the month ended 5 August 2024.
- 19 August 2024 – CIS tax deducted for the month ended 5 August 2024 is payable by today.

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 or contact@compassaccountants.co.uk

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