TAXANGLES from COMPASS ACCOUNTANTS

A newsletter for proactive planning...

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February 2025 Issue

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Using salary sacrifice to beat the rise in employer's NIC

One of the more unpopular Budget announcements was the rise in employer's National Insurance from 13.8% to 15% from 6 April 2025. The Class 1A rate and Class 1B rate are similarly increased, meaning that it will hit employers on the provision of both cash pay and taxable benefits. It will also make it more expensive for employers to settle an employee's tax liability through a PAYE Settlement Agreement; Class 1B contributions apply on both the items included in the agreement in place of the Class 1 or 1A liability that would otherwise arise, and also on the tax due under the agreement.

Consider a salary sacrifice arrangement

The introduction of the alternative valuation rules from 6 April 2017 stripped away the advantages of using a salary sacrifice arrangement for all but a handful of benefits. However, for those benefits which remain outside the alternative valuation rules, including pension savings, the use of a salary sacrifice arrangement provides the opportunity for National Insurance savings for both the employer and the employee.
Assume an employee wishes to top up their pension by making additional contributions of £500 a month. While pension contributions attract tax relief, there is no equivalent relief for National Insurance, so National Insurance must be calculated on gross pay before the deduction of those contributions. For the employee, this will mean a National Insurance hit of £40 a month where those earnings fall between the primary threshold and the upper earnings limit, and £10 if they fall above the upper earnings limit. For the employer, the hit is £69 a month for 2024/25, rising to £75 a month for 2025/26.

If instead the employee enters into a salary sacrifice arrangement with their employer to give up £500 of their cash salary each month in return for the employer making a contribution of £500 into their pension scheme, the employee's gross pay will fall by £500 a month, saving them between £10 and £40 a month in employee contributions.

The employer will save employer contributions, which for 2025/26 on £500 a month equates to an annual saving of £900. The employee's pension still receives a contribution of £500 a month, but both the employee and the employer save National Insurance contributions in the process.

A salary sacrifice arrangement can also be used to similar effect to provide tax-free benefits that fall outside the alternative valuation rules, such as employer-provided cycles and cycling safety equipment.

A word of caution: for a salary sacrifice arrangement to be effective, the employee's contract must be amended to reflect their lower cash pay and the provision of the benefit. The employee must not be able to revert to the higher salary at will.

Starting a business as a sole trader

When starting a business, there are various decisions to make and tasks to perform. One of the first questions to address is whether to run the business as a sole trader, whether to set up a partnership with others or whether to form a company. The way in which a business is operated will determine the taxes that are payable and legal obligations that must be met. A person operating as a sole trader is in business for themselves. This is arguably the simplest way to run a business.

Registering with HMRC

A person operating as a sole trader will need to register with HMRC for Self Assessment if they have trading income of £1,000 or more. This is the total from all unincorporated businesses, not per business.
If a person is already registered for Self Assessment, for example, because they have investment income or income from property to report to HMRC, they do not need to register again. Rather, they will simply need to complete the Self-Employment pages of the return to report details of their business income.

If a new trader is not registered for Self Assessment, they will need to do so by 5 October following the end of the tax year in which they first became liable to register. For example, if a person started a business in 2024/25 and their turnover was more than £1,000, they will need to register for Self Assessment no later than 5 October 2025. A person can register via the Gov.uk website (see www.gov.uk/register-for-self-assessment).
A person who has previously been registered for Self Assessment, but did not file a return for the last tax year, will need to register again to reactivate their account.

Tax and National Insurance

A sole trader must pay income tax on their profits. Their profits form part of their total taxable income, which will be liable to income tax to the extent that it exceeds their personal allowance for the tax year. For 2024/25 and 2025/26, the personal allowance is £12,570. Income tax is charged at 20% on the first £37,700 of taxable income. Taxable income in excess of £37,700 up to £125,140 is taxed at 40%, and anything over £125,140 is taxed at 45%.

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Where adjusted net income exceeds £100,000, the personal allowance is reduced by £1 for every £2 of income in excess of £100,000, such that anyone with adjusted net income in excess of £125,140 does not receive a personal allowance.

Self-employed individuals must pay Class 4 National Insurance if their profits exceed £12,570. This is payable at a rate of 6% on profits between £12,570 and £50,270 and at 2% on any profits in excess of £50,270. Where profits exceed the small profits threshold (set at £6,725 for 2024/25 and increasing to £6,845 for 2025/26), no Class 4 National Insurance contributions are payable.

However, the trader will earn a National Insurance credit which will provide them with a qualifying year for state pension purposes. Sole traders with profits which are below the small profits threshold can opt to pay voluntary Class 2 contributions to build up their state pension entitlement. At £3.45 per week for 2024/25 (increasing to £3.50per week for 2025/26), this is a much cheaper option than paying voluntary Class 3 contributions, and may be beneficial if the sole trader would not otherwise secure a qualifying year.
Tax and Class 4 National Insurance contributions must be paid by 31 January following the end of the tax year. Once the tax and Class 4 liability reaches £1,000, payments on account must be made for future tax years.

VAT

A sole trader will need to register for VAT if their VATable turnover exceeds the VAT registration threshold of £90,000 in the previous 12 months, or is expected to do so in the next 30 days.

Records

The sole trader will need to keep records of their business income and expenses to enable them to work out their taxable profits. It is a good idea to have separate personal and business bank accounts to avoid personal and business expenses getting mixed up. The trader should also keep invoices, receipts, etc.

Claim a refund if you have overpaid tax

There are various reasons why tax may be overpaid, and when more tax has been paid than is due, it is understandable that the taxpayer will want this to be refunded as soon as possible. The process for claiming a refund depends on why the overpayment arose.

Employees

An employee may have paid too much tax on their employment income. This may be the case if their tax code is incorrect or because they have incurred expenses on which tax relief is due. A claim for relief for employment expenses can be made using the online service on the Gov.uk website or by post on form P87. It is important to include the required supporting evidence with the claim.

If the employee has received a tax calculation letter (P800) showing that they are due a refund, they should follow the instructions in the letter for claiming that refund. Where the letter indicates that the claim can be made online, the claim should be made using the online service on the Gov.uk website at www.gov.uk/tax-overpayments-and-underpayments/if-youre-due-a-refund. The claimant will need to provide the reference number from the P800 letter and their National Insurance number. The refund should be made to the claimant's bank account within five days. A refund can also be claimed through the taxpayer's personal tax account or using the HMRC app, or by writing to HMRC. Where the tax calculation letter informs the taxpayer that they will be sent a cheque, they do not need to make a claim as the cheque will be sent to them by post. This should be received within 14 days of the date on the P800 letter. Taxpayers who have yet to receive a P800 for 2023/24 should receive it by the end of the March.

Self Assessment overpayments

A taxpayer may be due a refund under Self Assessment if their income has fallen and the payments made on account exceed their liability for the year. They may also be due a repayment if a loss relief claim has been made. An application for a refund where tax has been overpaid can be made in the return, and where this has been done HMRC will usually send the repayment automatically within two weeks of the return being submitted. If a refund was not requested in the return, it can be claimed through the taxpayer's online Self Assessment account. They simply need to choose the 'Request a Repayment' option and follow the instructions.

A refund can also be claimed through the taxpayer's personal tax account by selecting 'Claim a refund' and following the instructions. A similar process is followed where a refund is claimed through a business tax account. Refunds can be paid into UK bank accounts, or the taxpayer can request a cheque. A refund is normally paid within two weeks of making a claim.

Deferring Class 1 National Insurance contributions

Where an employee has more than one job, they may be able to defer the payment of Class 1 National Insurance contributions in one or more of those jobs to ensure that the contributions that they pay for the year do not exceed the annual maximum.

If earnings in one job are at least equal to the upper earnings limit, the employee will pay primary contributions on that job at the main rate on all earnings between the primary threshold and the upper earnings limit. Where this is the case, they only need to pay contributions at the additional rate of 2% on earnings from other jobs where these exceed the primary threshold. To prevent an overpayment from arising, the employee can apply for a deferment. A person with two jobs can make a deferment application if they earn at least £967 per week from one job and at least £242 per week from the other job.

Where a person has multiple jobs, it may still be possible to apply for a deferment where the earnings are less than £967 per week in all jobs if instead the earnings test is met. The earnings test is found by applying the formula: UEL + (E – 1) WPT. Where UEL is the weekly upper earnings limit (set at £967 for 2024/25 and 2025/26), E is the number of employments and WPT is the weekly primary threshold (set at £242 for 2024/25 and 2025/26). The following table summarises the earnings criteria for between two and six employments. Contributions can be deferred for any jobs not taken into account in reaching the earnings criterion.

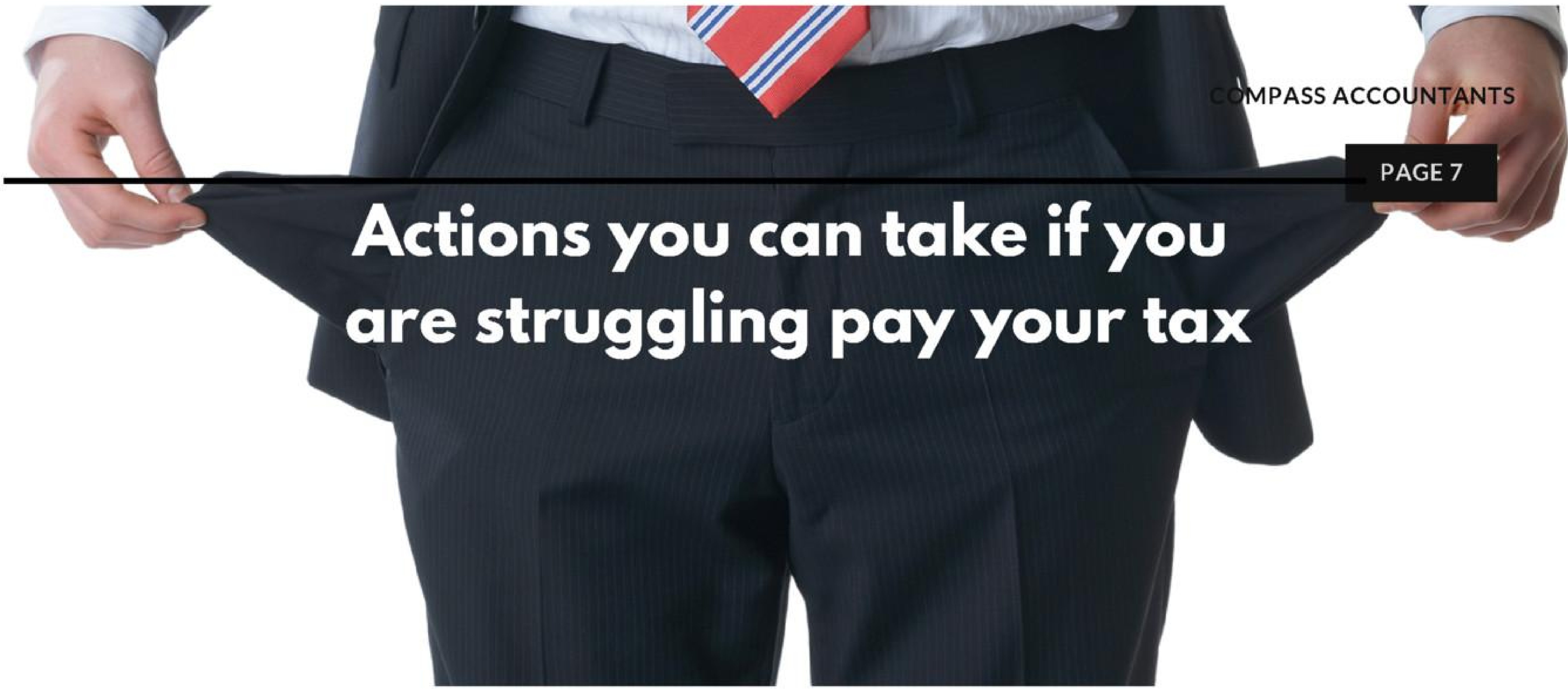
Number of employments	Weekly earnings needed for deferment to be possible
2	£1,209
3	£1,451
4	£1,693
5	£1,935
6	£2,177

Example

Jack has three jobs. In job 1 he earns £800 per week, in job 2 he earns £750 per week and in job 3 he earns £400 per week. As his total earnings from job 1 and 2 of £1,550 per week exceed the earnings criterion of £1,451 for three jobs, he can apply for a deferment for job 3. If this is granted, he will pay Class 1 NICs at 2% on earnings in excess of £242 per week rather than at 8%.

A deferment application can be made online or by post on form CA72A. Ideally, the application should be made before the start of the tax year, although postal applications will be accepted if received by 14 February in the tax year. Where the application is received after 14 February but before the end of the tax year, it will only be considered with the agreement of the employers in respect of which deferment is sought.

If an application is made too late and contributions are paid in excess of the annual maximum, a refund can be claimed after the end of the tax year by writing to HMRC.



Actions you can take if you are struggling pay your tax

Tax due under Self Assessment for 2023/24 should have been paid in full by midnight on 31 January 2025, along with the first payment on account for 2024/25. Financially, January is a difficult time for many people and they may be unable to find the funds to pay all the tax that they owe. Where this is the case, ignoring the problem will not make it go away; rather, it will make it worse as interest and penalties will be charged, increasing the amount that will have to be paid to HMRC to clear the bill.

As far as interest and penalties are concerned, interest is charged from the due date to the date of payment. Currently, interest on overdue tax is charged at 2.5% above the Bank of England base rate. At the time of writing, the late payment rate was 7.25%. However, from April 2025, interest on overdue tax will be charged at a rate of 4% above the Bank of England base rate. It is easy to see how this can soon mount up. If tax remains due 30 days after the deadline, a penalty of 5% of the unpaid tax is charged. Further penalties of 5% of the unpaid tax are charged six months after the due date and 12 months after the due date.

Payment plans

However, there are steps that can be taken to take control of the situation and to clear the debt. One option is to set up a Time to Pay arrangement to pay the tax in instalments. It may be possible to do this online. Although interest will still be charged where payment is made in instalments, there will be no penalties to pay.
A taxpayer should be able to set up a Self Assessment payment plan online if all of the following apply:
·the latest tax return (i.e. that for 2023/24) has been filed;
·the date is within 60 days of the payment deadline;
·the amount owed is £30,000 or less; and
·the taxpayer does not have any other payment plans or debts with HMRC.

Taxpayers who are unable to set up a payment plan online should contact HMRC to see if it is possible to agree to pay what they owe in instalments. HMRC will take into account their income and expenses, and also whether they have any savings. Taxpayers with savings will be expected to use these to pay any tax that they owe.

When setting up a plan, it is important to be realistic about the payments and ensure that these are manageable – the taxpayer can always clear the debt earlier if they are able to do so. If a payment is missed, HMRC will usually contact the taxpayer to find out why. They may let the taxpayer renegotiate the plan. However, if payments are regularly missed, HMRC may start action to collect the debt in full. This may involve instructing a debt collector or collecting the tax direct from the taxpayer's wages or bank or building society account. If the tax remains unpaid, HMRC may instigate court action.

Plan ahead

To ensure that money is put aside to meet future tax bills, consideration could be given to setting up a budget plan. This works a bit like a savings account in that the taxpayer makes regular payments to HMRC which are set against future tax bills. If the taxpayer has not put enough aside to meet the bill, the balance must be paid by the normal due date.

TAX DIARY

FEBRUARY

1st February - For companies with April year ends Corporation Tax is due
7th February - Electronic Payments of VAT must have reached HMRC
7th February - Electronic Submission of VAT returns deadline
19th February - January's PAYE and Class 1 NIC Postal Payments must reach HMRC
22nd February - January's PAYE and Class 1 NIC Electronic Payments must be cleared to HMRC
28th February - For companies with February year ends Corporation Tax Returns are due

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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