TAXANGLES from COMPASS ACCOUNTANTS

A newsletter for proactive planning...

In this edition...

January 2025 Issue

- What expenses can you deduct if you are self-employed?
- Using ISAs to benefit from tax-free savings income
- Is it worth paying voluntary Class 3 NICs?
- Using the VAT flat rate scheme
- What to do if you cannot pay your tax bill
- Tax Diary

www.compassaccountants.co.uk

What expenses can you deduct if you are self-employed?

If you are self-employed, you will pay tax on your taxable profit. In working out your taxable profit, you can deduct certain expenses that you have incurred in running your business. The basic rule is that expenses can be deducted if they are incurred wholly and exclusively for the purposes of the trade.

This rule precludes a deduction for private expenditure. Where possible, it is advisable to use separate bank accounts for business and personal expenditure to keep them separate and reduce the risk of missing business expenses or deducting private expenses in error. Where an expense has both a private and a personal element, it is permissible to claim a deduction for the business part, as long as the business expenditure and the private expenditure can be identified separately. This may be the case, for example, where a car is used for both business and personal travel. Here a deduction for business travel could be claimed using the simplified rates published by HMRC. However, where it is not possible to separate the business and personal costs and the expenditure has a dual purpose, a deduction is not permitted. An example of this would be everyday clothes worn for work, as even if the clothes are only worn for work, they also provide the personal benefits of warmth and decency.

If you use the cash basis, you can claim a deduction for revenue expenditure and also capital expenditure where it is of a type for which a deduction is allowed under the cash basis. However, if you use traditional accounting, you can only deduct revenue expenditure; relief for capital expenditure is given in the form of capital allowances.

Typical expenses

A business may incur some or all of the following expenses, which can be deducted in calculating its taxable profit, as long as the costs are incurred wholly and exclusively for the purposes of the business:

·Office costs, such as stationery and printing costs and phone bills
·Travel costs, such as fuel, train, taxi and bus fares, or parking
·Uniforms bearing the business's logo or name (but not ordinary everyday clothing)
·Goods purchased for resale
·Raw materials
·Costs related to the business premises, such as rent, light and heat
·Insurance
·Advertising or marketing costs.

Trading allowance

Rather than claiming a deduction for your actual expenses, you can instead opt to deduct the £1,000 trading allowance. This will be advantageous if your actual expenses are less than £1,000. If your gross trading income (before deducting expenses) is £1,000 or less, you do not need to pay tax on it, or report it to HMRC.

Simplified expenses

To save work, instead of deducting actual expenses in relation to vehicles and expenses incurred if you run your business from home, you can use simplified expenses to work out the deduction. You can also use simplified expenses to work out the private use disallowance if you live in your business premises (as might be the case, for example, if you run a Bed and Breakfast).

Records

It is important to keep good business records so that you can identify your expenses and take them into account when working out your taxable profit. If you overlook deductible expenses, you will pay more tax than you need to.

Using ISAs to benefit from tax-free savings income

A combination of higher interest rates and stealth taxation may mean that you are now paying tax on savings income for the first time. If this is the case, it may be worth taking out an Individual Savings Account (ISA) to enjoy more of your investment income tax-free. ISAs are available from a number of financial institutions, including banks and building societies, credit unions, friendly societies, stockbrokers, peer-to-peer lending services and crowdfunding companies.

There are different types of ISAs for persons aged 18 and over:
·cash ISA;
·stocks and shares ISA;
·innovative finance ISA;
·Lifetime ISA.
The previous Government had announced plans to introduce a British ISA. However, the current Government are not going ahead with it.
There is also a Junior ISA for children under the age of 18.

ISA limit

There is an annual ISA investment limit of £20,000 in a tax year. The limit may be invested in a single account or spread across different types of accounts. The maximum amount that can be invested in a Lifetime ISA is £4,000 a year. Spouses and civil partners each have their own limit. A separate limit of £9,000 per year applies to Junior ISAs.

Cash ISA

Savings in a cash ISA can be held in bank and building society accounts and in some National Savings products. Interest earned on savings held within a cash ISA is tax-free.

Stocks and shares ISA

Investments within a stocks and shares ISA can include shares in companies, unit trusts and investment funds, corporate bonds and Government bonds. However, shares owned in a personal capacity cannot be transferred into a stocks and shares ISA, although it is possible to transfer shares from an employee share scheme into an ISA. Income and gains from the investments held within the ISA are tax-free.

Innovative finance ISA

Investments within an innovative finance ISA can include peer-to-peer loans (i.e. loans given to other people or businesses without using a bank), crowdfunding debentures (i.e. investments in a business by buying its debt) and funds where the notice or redemption period means that the funds cannot be held in a stocks and shares ISA. Arrangements that are already in existence outside the innovative finance ISA cannot be transferred into an innovative finance ISA. Income and gains on investments within an innovative finance ISA are tax-free.

Lifetime ISA

A Lifetime ISA is designed to help people to save either for their first home or for retirement. Cash and stocks and shares can be held in a Lifetime ISA. Returns are tax-free. Lifetime ISAs also benefit from a tax-free Government bonus equal to 25% of the amount saved, capped at £1,000 a year. However, there are more conditions than for other ISAs.

The maximum amount that can be invested in a Lifetime ISA is £4,000 a year. This counts towards the overall limit on investments in ISAs, set at £20,000 per tax year.

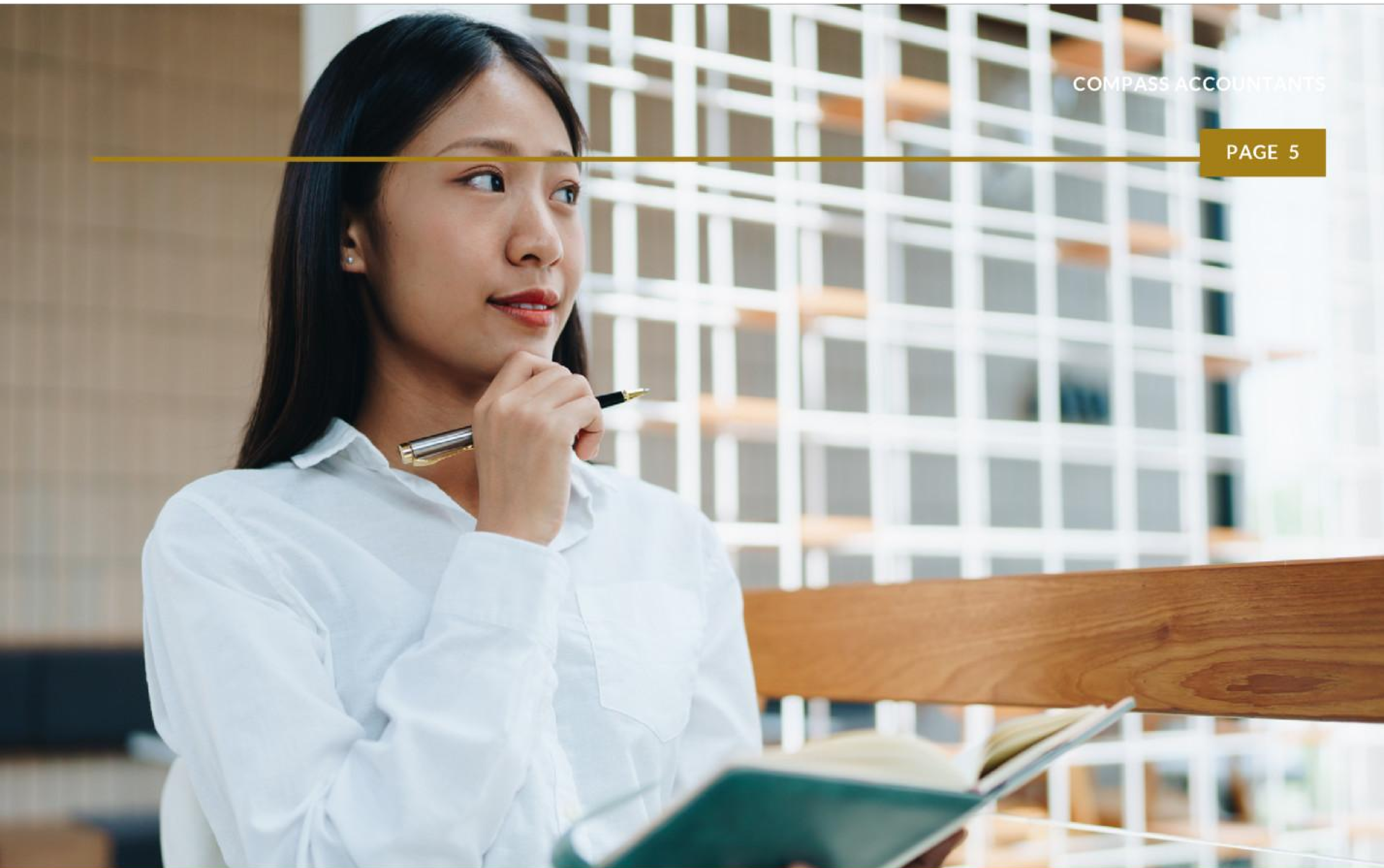
A person must be aged 18 or over and under 40 to open a Lifetime ISA and the first payment must be made into the account before the individual turns 40. Once an account is open, the individual can continue to contribute up to £4,000 a year until they reach the age of 50. Beyond age 50, the account remains open and will continue to earn interest, but no further deposits can be made and no further government bonuses will be paid.

Money can only be withdrawn from a Lifetime ISA without penalty where it is used to buy a first home once the individual has reached age 60 or if they are terminally ill with less than 12 months to live.

On the face of it, the 25% Government bonus makes a Lifetime ISA an attractive option for saving for a deposit for a first home. However, the money in a Lifetime ISA can only be used in this way if the home is purchased with a mortgage and does not cost more than £450,000. In London and other areas with high property prices, buyers may struggle to find a first home within this price bracket. If a first home is purchased for more than this, the saver has the choice of either leaving the funds in the account until they reach the age of 60 or withdrawing the money saved and forfeiting the government bonus. The bonus will be clawed back if the funds are withdrawn other than for one of the three permitted reasons.

Junior ISAs

A Junior ISA is a long-term tax-free savings account for children. There are two types of Junior ISA, a cash ISA or a stocks and shares ISA and a child can have one or both types. The account can be opened by a parent or a guardian with parental responsibility. However, the money belongs to the child. As any interest is tax-free and not taxed on the parent, a Junior ISA is an attractive option for a parent wishing to save for their child. The child can take control of the account when they reach the age of 16, but cannot withdraw the money until they turn 18.



Is it worth paying voluntary Class 3 NICs?

The payment of National Insurance contributions is linked to entitlement to the state pension. If sufficient National Insurance contributions of the right type are paid for a tax year, that year counts as a qualifying year for state pension and benefit purposes. A person may also secure a qualifying year if they are awarded National Insurance credits for that year. This may be because they have low earnings or are in receipt of certain benefits, such as child benefit or carer's allowance.

People reaching state pension age on or after 6 April 2016 need 35 qualifying years for a full state pension and at least ten qualifying years to receive a reduced state pension.

Different classes of NIC

Employed and self-employed earners pay different classes of contribution. Employed earners pay Class 1 contributions if their earnings exceed the primary threshold. For 2024/25 this is set at £242 per week, £1,048 per month and £12,570 per year. However, where their earnings are between the lower earnings limit (set at £123 per week, £533 per month and £6,396 per year) and the primary threshold, the employee is treated as if they had paid National Insurance contributions, albeit it at a zero cost. Where earnings in the tax year are equal to 52 times the weekly lower earnings limit (so, £6,396 for 2024/25), the earner secures a qualifying year for state pension purposes. Employed earners whose earnings are below this level will not build up state pension entitlement via their earnings. Contributions payable by the employer (secondary Class 1, Class 1A and Class 1B) do not provide any pension or benefit rights for employees.

Self-employed earners now build up entitlement through the payment of Class 4 contributions, in respect of which a liability arises where their profits from self-employment are more than the lower profits limit (set at £12,570 for 2024/25). Where profits are between the small profits threshold (set at £6,725 for 2024/25) and the lower profits limit, the self-employed earner receives a National Insurance credit which provides them with a qualifying year.

CONT ON PG 6

For 2023/24 and earlier tax years, self-employed earners built up their state pension entitlement through the payment of Class 2 contributions; for 2023/24 and earlier tax years, the payment of Class 4 contributions did not provide any pension or benefit rights.

Self-employed earners whose profits are below the small profits threshold can pay voluntary Class 2 contributions to preserve their state pension entitlement.

Voluntary Class 3 contributions

Individuals who will not have 35 qualifying years by the time that they reach state pension age may want to pay voluntary Class 3 contributions in order to boost their state pension. However, before paying the contributions, it is important to check that doing so will be beneficial. An individual can check their National Insurance record and state pension forecast online on the Gov.uk website or via the HMRC app. Making voluntary contributions is only worthwhile if a person will not otherwise have 35 qualifying years when they reach state pension age and if, after making the contributions, they will have at least ten qualifying years. This is the minimum needed for a reduced state pension. An individual may also be able to pay voluntary contributions if they have reached state pension age and want to plug gaps in their record to boost their state pension.

Class 3 contributions for 2024/25 are payable at the rate of £17.45 per week. Class 3 contributions must normally be paid no later than six years from the end of the tax year to which they relate (so by 5 April 2031 for 2024/25 contributions). Where contributions are paid after the end of the tax year to which they relate, they are usually paid at the current rate where this is higher. Individuals who have gaps in their National Insurance record between 6 April 2006 and 5 April 2016 can make voluntary contributions at the 2022/23 rate of £15.85 per week until 5 April 2025 to plug those gaps.

Self-employed earners with profits below the small profits threshold can pay voluntary Class 2 contributions instead of voluntary Class 3. This is a much cheaper option (£3.45 per week for 2024/25 rather than £17.45 per week). They can also plug gaps in their record between 6 April 2006 and 5 April 2016 by making contributions at the 2022/23 Class 2 rate of £3.15 per week by 5 April 2025.

Using the VAT flat rate scheme

The VAT flat rate scheme is a simplified flat rate scheme which can be used by smaller businesses to save work. Under the scheme, businesses pay a set percentage of their VAT inclusive turnover to HMRC rather than the difference between the VAT that they charge and the VAT they suffer on the goods and services that they buy. The percentage that they need to pay depends on the sector in which they operate, and also on whether they are a limited cost business. The main advantage of the scheme is that it reduces the work in complying with VAT. For example, there is no need to record the VAT on purchases. However, for some businesses this may come at a cost, as the amount that they pay over to HMRC may be more than would be payable under traditional VAT accounting. Before joining the scheme, it is advisable to do the sums.

Eligibility

A business is eligible to join the scheme if it is VAT registered and it expects its VAT taxable turnover to be £150,000 or less in the next 12 months. This is everything that is sold that is not exempt from VAT. However, a business is not allowed to re-join the scheme if it has used it previously and left within the previous 12 months. The VAT flat rate scheme cannot be used by businesses that use a margin or capital goods scheme, nor can it be used with the cash accounting scheme; instead, the flat rate scheme has its own cash-based method to determine turnover.
A business must leave the scheme if, on the anniversary of joining, its turnover in the last 12 months was more than £230,000 including VAT, or it is expected to be so in the next 12 months. A business must also leave if they expect their turnover in the next 30 days to be more than £230,000 including VAT.

The flat rate

The flat rate depends on the type of business. The percentages can be found on the Gov.uk website at www.gov.uk/vat-flat-rate-scheme. A business benefits from a discount of 1% in its first year of VAT registration. Businesses that are classed as a limited cost business, pay a higher rate of 16.5% regardless of the sector in which they operate. This is a business whose spend on relevant goods is less than either 2% of its turnover or £1,000 a year (£250 a quarter) if more than 2% of turnover. Where costs are close to 2% of turnover, the business may need to perform the calculation each quarter to ascertain whether they need to use the limited cost business percentage of 16.5% or that for their sector.

Not everything that a business purchases counts as ‘goods’ for the purposes of the calculation – only ‘relevant goods’ count. The main exceptions are services, such as accounting and advertising, car fuel (unless the business operates in the transport sector) and rent. Where a business incurs significant costs on services or fuel but their other goods amount to less than 2% of their turnover, they may be better off using traditional accounting. The limited cost business percentage of 16.5% of VAT inclusive turnover equates to 19.8% of VAT exclusive turnover, leaving only a narrow margin to cover any VAT suffered.

Example

A photography business joins the VAT flat rate scheme and in its first quarter has VAT inclusive turnover of £24,000 (£20,000 plus VAT). Its relevant goods in the quarter are £1,250. As this is more than 2% of the turnover, the business is not a limited cost business. The flat rate percentage for its sector is 11%. However, as it is in the first year as a VAT registered business it benefits from a discount of 1%. Therefore, it must pay VAT of £2,400 to HMRC (10% of £24,000).

Capital goods

If you opt for the flat rate scheme, you will not normally be able to claim back VAT separately on capital goods unless they cost more than £2,000 and you do not intend to resell them.

What to do if you cannot pay your tax bill

As the cost of living crisis continues to bite, you may find that come 31 January 2025 you are struggling to pay your Self Assessment tax bill. If this is the case, it is important that you do not bury your head in the sand – the bill will not go away and, with the addition of interest and penalties, will become bigger. However, there are options available which may allow you to pay what you owe over a longer period.

Coding out

If you filed your 2023/24 tax return online by 30 December 2024 or filed a paper return before 31 October 2024 and you have PAYE income, if you owe £3,000 or less, HMRC will collect what you owe by adjusting your tax code for 2025/26. This effectively allows you to pay in interest-free instalments and is something of a good deal.

Time to Pay Arrangements

To spread the cost, you may be able to pay your bill in instalments by setting up a Time to Pay Arrangement with HMRC. You may be able to do this online if all of the following apply:

1. You have filed your 2023/24 tax return.
2. You owe £30,000 or less.
3. You are within 60 days of the 31 January deadline.
4. You do not have any other payment plans with HMRC.

You can do this by logging into your HMRC account.

If you are unable to set a plan up online, you may be able to do so by calling HMRC on 0300 200 3820. You will need to provide details of your income and outgoings.

Where an arrangement is set up, you will be charged interest on the tax paid after the due date. However, penalties are not applied. The arrangement is designed to be flexible and if you are able to you can clear it early to save interest. If you struggle to meet the repayments under the arrangement, the best course of action is to contact HMRC to try and renegotiate the agreement, for example to pay your tax over a longer period. If you fall behind or do not pay what you owe and

do not agree a revised plan with HMRC, they may take action to recover what you owe.
HMRC currently charge interest at 2.5% above base. This is to increase to 4% above base from April 2025. If you are able to borrow money at a lower rate, it may be preferable to take out a loan to pay your tax than to use a Time to Pay Arrangement.

Budget Payment Plans

Looking ahead, you may find it easier to set aside some money to pay your tax bills. While you can simply have a separate bank account for this purpose, you may prefer instead to set up a Budget Payment Plan with HMRC so that you cannot dip into the account in the year. A Budget Payment Plan allows you to put money aside for your next Self Assessment bill by making regular weekly or monthly payments to HMRC. If the amount put aside is less than the amount you owe, the balance must be paid by the due date. If you have put aside more than you need, you can ask for a refund. You can pause payments for up to six months.

As long as your tax affairs are up to date, you can set up a Budget Payment Plan through your online HMRC account.

Review payments on account

If your 2023/24 tax and Class 4 NIC bill is more than £1,000 and you do not pay at least 80% of your tax through deduction at source, such as via PAYE, you will need to make payments on account of your 2024/25 tax liability. Each payment is 50% of your tax and Class 4 bill for 2023/24 and payments are due on 31 January 2025 and 31 July 2025. It is advisable to review your payments on account. If your income has fallen and you expect to owe less for 2024/25 than for 2023/24, you can opt to reduce your payments on account. However, if you reduce them too much, interest will be charged on the shortfall.

TAX DIARY

JANUARY

- 1 January 2025 – Due date for Corporation Tax due for the year ended 31 March 2024
- 19 January 2025 – PAYE and NIC deductions due for month ended 5 January 2025. (If you pay your tax electronically the due date is 22 January 2025).
- 19 January 2025 – Filing deadline for the CIS300 monthly return for the month ended 5 January 2025.
- 19 January 2025 – CIS tax deducted for the month ended 5 January 2025 is payable by today.
- 31 January 2025 – Last day to file 2023-24 self-assessment tax returns online.
- 31 January 2025 – Balance of self-assessment tax owing for 2023-24 due to be settled on or before today unless you have elected to extend this deadline by formal agreement with HMRC. Also due is any first payment on account for 2024-25.

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

To subscribe to the newsletter, so that each edition is delivered to your inbox, go to www.compassaccountants.co.uk and add your contact details.