TAXANGLES from COMPASS ACCOUNTANTS

A newsletter for proactive planning...

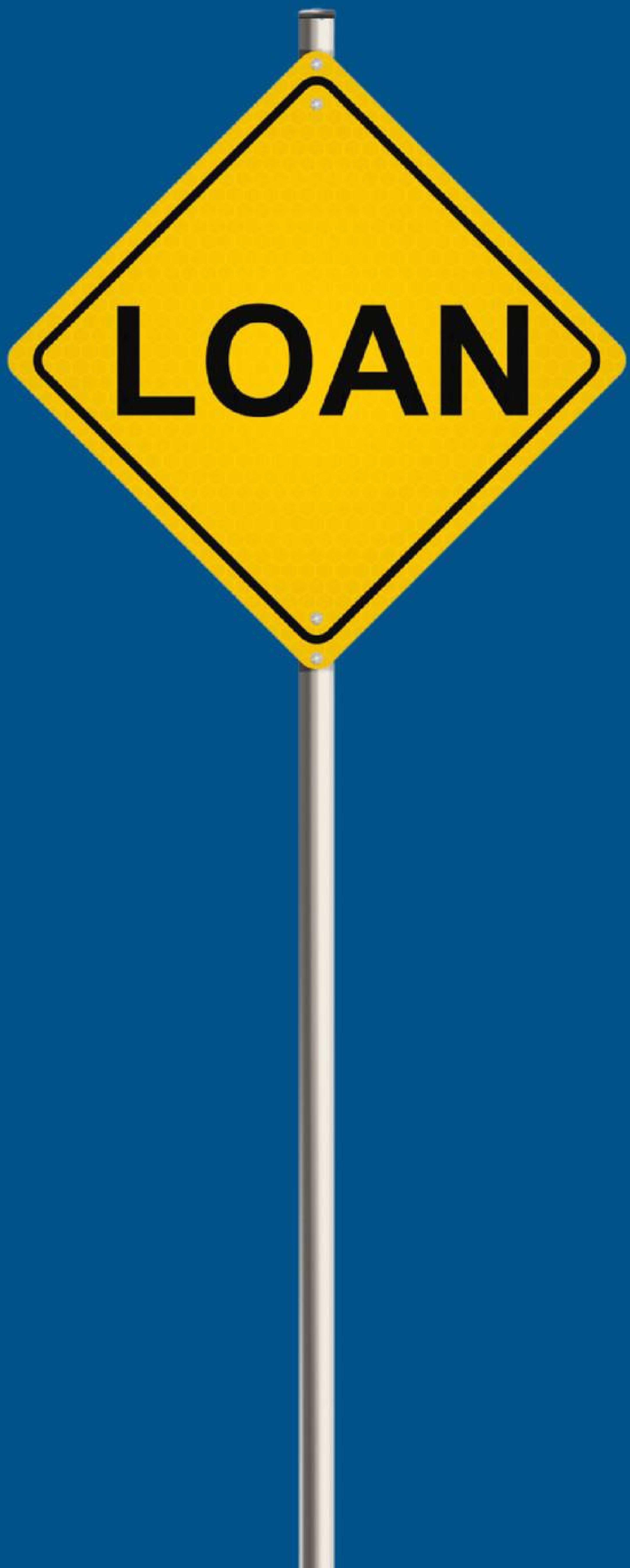
In this edition...

- Overdrawn director's loan account – must your company pay tax on the balance?
- Setting up as a sole trader
- File your tax return by 30 December to pay what you owe through PAYE
- Home responsibilities protection – do you have missing years?
- VAT invoice and accounting controls

November 2024 Issue

www.compassaccountants.co.uk

Overdrawn director's loan account – must your company pay tax on the balance?



In personal and family companies, the lines between the company's finances and the director's finances may become blurred. A director may withdraw money from the company for personal use or may lend money to the company. The company may pay some of the director's personal bills, and the director may personally meet some company expenses. The director's loan account is simply an account for recording the transactions between the director and the company in much the same way as a bank account.

At the company's year end, the director's loan account may show a zero balance. Alternatively, the account may be in credit. This may be the case if the director has provided a loan to the company or personally met company expenses. The third scenario is that the director's loan account is overdrawn. Where this is the case, the director owes money to the company.

Implications of an overdrawn director's loan account

An overdrawn director's loan account may have tax implications for both the director and the company. This will depend on the loan account balance and whether it is cleared by the corporation tax due date.

As far as the company is concerned, if the director's loan account balance remains outstanding on the date on which corporation tax for the period is due (which is nine months and one day after the company's year end), the company will need to pay tax on the balance at that date. The tax is paid at the same time as the corporation tax for the period, but crucially is not corporation tax. The charge is imposed by section 455 of the Corporation Tax Act 2010 and is generally referred to as 'section 455 tax'.

The rate of section 455 tax is aligned with the dividend upper rate, currently 33.75%. Unlike most taxes, it is refundable once the loan has been cleared, with the tax becoming repayable nine months and one day from the end of the accounting period in which the loan is cleared (i.e. the corporation tax due date for that period).

CONT ON PG 3

The tax is to a certain extent voluntary as there will be no section 455 tax to pay if the director clears the overdrawn balance ahead of the corporation tax due date. There are various ways in which this can be done. For example, the director could introduce personal funds to the company, the company could declare a dividend to clear the loan balance or pay a bonus. However, there may be a tax cost of clearing the loan and, where this is higher than the section 455 tax, it may be preferable to pay the section 455 tax instead, reclaiming it when the loan balance can be cleared in a more tax-efficient manner.

If the outstanding loan balance tops £10,000 at any point in the tax year, the director will be liable to a benefit in kind charge on interest on the loan balance at the official rate (assuming the director pays no interest on the loan). The company will also pay Class 1A National Insurance at 13.8% on the taxable amount. However, there is no tax or Class 1A National Insurance to pay if the balance remains below £10,000, enabling a director to borrow up to £10,000 for up to 21 months (if the loan is taken out at the start of the accounting period) tax and interest-free. This can be worthwhile.

Setting up as a sole trader

When starting a business, there are a number of ways in which this can be done. Options include operating as a sole trader, forming a partnership or setting up a limited company. Of these, operating as a sole trader is the simplest.

Taxes you must pay

If you run an unincorporated business as a sole trader, you are self-employed for tax purposes. If you make a profit, you will need to pay income tax on that profit if your total taxable income for the year is more than your tax-free allowances. Unlike a company, the tax bill for your business is not worked out separately; rather, it is taken into account in working out your overall personal tax liability for the tax year. Depending on your profit level, you may also need to pay Class 4 National Insurance.

Registering as a sole trader

You only need to tell HMRC about income from self-employment if you earn more than £1,000 in the tax year before deducting expenses. The £1,000 limit applies across all your self-employments, rather than per business. This £1,000 limit is known as the trading allowance. Where your income exceeds the trading allowance, you will need to register for Self Assessment if you are not already registered. You can do this online -

CONT ON PG 4

(see www.gov.uk/register-for-self-assessment). This must be done by 5 October following the end of the tax year in which a liability first arose.

National Insurance

If your profits from self-employment are more than £12,570 for 2024/25, you will need to pay Class 4 National Insurance. For 2024/25, this is at the rate of 6% on profits between £12,570 and £50,270 and at the rate of 2% on profits in excess of £50,270. The payment of Class 4 National Insurance will earn you a qualifying year for state pension purposes.

If your profits are between £6,725 and £12,570, you will not have to pay any Class 4 National Insurance, but you will be awarded a National Insurance credit which will give you a qualifying year for state pension purposes for free. If your profits are less than £6,725 for the tax year, you will not receive the National Insurance credit. However, you can pay Class 2 contributions voluntarily at the rate of £3.45 per week to help build up your state pension entitlement.

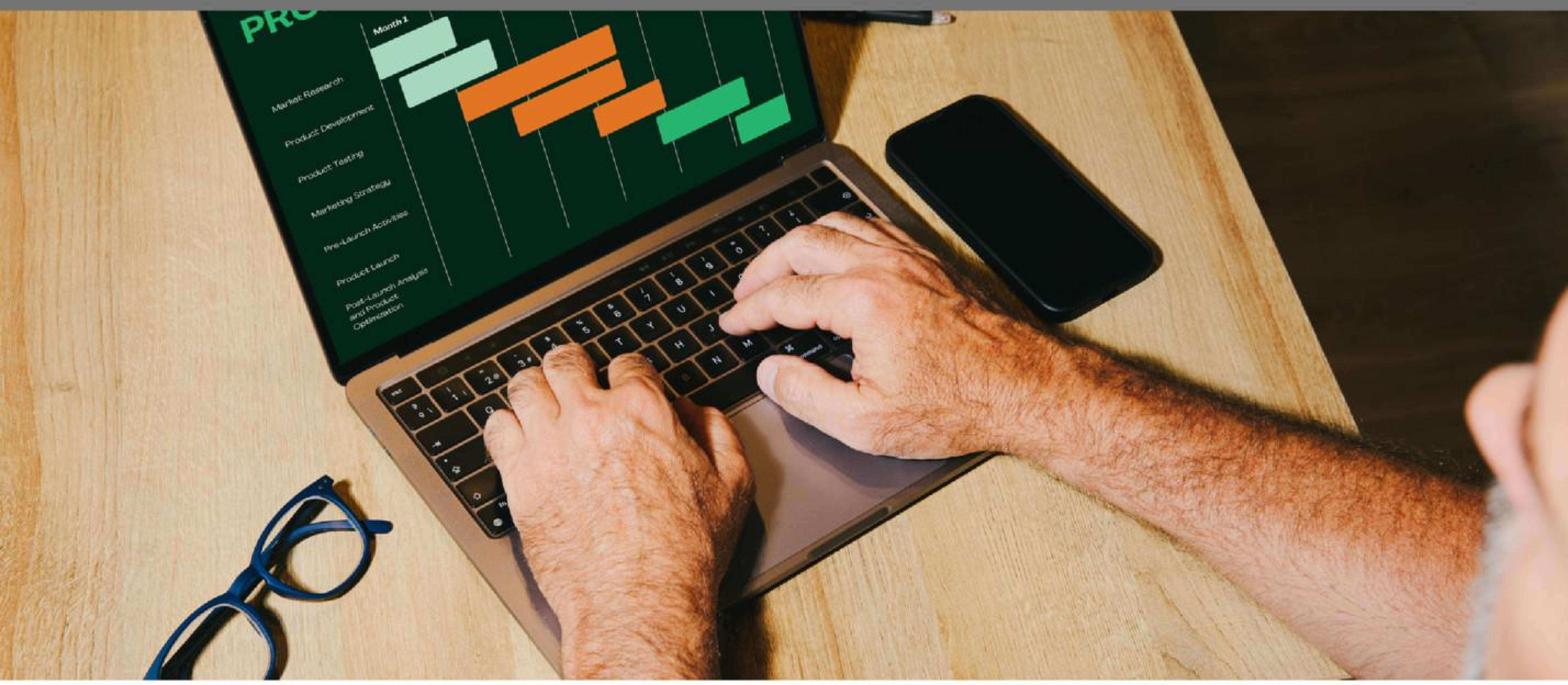
Keeping records

You will need to keep records of your income and business expenses so that you can work out your profit. The default basis of accounts preparation is now the cash basis, under which you only take account of cash in and cash out. When working out your profit, you can deduct the £1,000 trading allowance rather than actual expenses if this is more beneficial (which will be the case if your actual expenses are less than £1,000).

Paying tax and National Insurance

Under Self Assessment, your tax and Class 4 National Insurance bill must be paid by 31 January after the end of the tax year to which it relates (so by 31 January 2026 for your 2024/25 profit).

If your tax and Class 4 National Insurance bill for the previous tax year is £1,000 or more, you will need to make payments on account. This means that you will have to pay 50% of the previous year's liability on 31 January in the tax year and 31 July after the end of the tax year. Any balance due must be paid by 31 January after the end of the tax year. It is prudent to put away money each month so that you have it available to pay your tax bill. Alternatively, you can set up a budget plan with HMRC.



File your tax return by 30 December to pay what you owe through PAYE

If you pay tax through PAYE, as will be the case if you are an employee or a pensioner, you may need to complete a Self Assessment tax return if you have other sources of income, such as income from property or investments or from self-employment. If at least 80% of the tax that you owe is collected through PAYE, you will not have to make payments on account, even if the tax that you owe under Self Assessment is more than £1,000.

The normal deadline for paying tax under Self Assessment is 31 January after the end of the tax year, so by 31 January 2025 for 2023/24 tax. However, if you file your return earlier, you may be able to pay the tax that you owe through PAYE via an adjustment to your tax code.

30 December deadline

To take advantage of the opportunity to pay the tax that you owe for 2023/24 through PAYE, you must file your tax return by 30 December 2024 if you file online. If you have already submitted a paper return by the 31 October paper filing deadline, you may also qualify.

You will not be able to pay your tax through your tax code if:

- you do not have sufficient PAYE income for HMRC to collect the tax that is due;
- paying tax in this way will mean that more than 50% of your PAYE income is deducted in tax; or
- you will pay more than twice as much tax as you do normally.

Further, you can only pay the tax that you owe under Self Assessment in this way if the amount that you owe is £3,000 or less. It is important to note that this limit applies to the total amount of tax that you owe under Self Assessment – if you owe more than £3,000, you cannot make a part-payment to reduce the bill to £3,000 and then pay this through your tax code.

Where the return is filed on time, the amount that you owe is £3,000 or less, you already pay tax under PAYE and you are not otherwise excluded from paying your tax through PAYE, HMRC will automatically adjust your tax code to collect the tax that you owe, unless you specify on your tax return that you do not want the tax collected in this way. If you are not eligible to pay through PAYE despite your bill being £3,000 or less, you will need to pay what you owe by 31 January 2025, or set up a Time to Pay arrangement with HMRC.

Collection mechanism

To collect tax through PAYE, your tax code will be adjusted so that your tax-free allowances are reduced. The amount of the reduction will reflect both the tax that you owe and your marginal rate of tax. For example, if you are employed and owe tax under Self Assessment of £2,000 in respect of rental income and you are a higher rate taxpayer paying tax at 40%, your tax code will be adjusted by 500 (as 40% of £5,000 is £2,000). This will mean if you receive the basic personal allowance of £12,570, your tax-free allowance will be reduced by £5,000 and your tax code will be reduced to 757L.

To collect tax for 2023/24, the adjustment is made to the 2025/26 tax code, so that the tax is collected in 12 equal instalments throughout the 2025/26 tax year.

Advantages

Opting to pay tax through PAYE removes the need to pay the tax in a single payment by 31 January 2025. It also provides the option to pay in instalments without the need to set up a Time to Pay arrangement, with the added advantage that the instalments are interest-free. By contrast, interest is charged where tax is paid in instalments under a Time to Pay arrangement The first payment is not made until April 2025, providing a further cash flow benefit. On the downside, your take home pay will be reduced as a result.

Home responsibilities protection – do you have missing years?

Entitlement to the full state pension depends on having sufficient qualifying years. Where a person reaches state pension age on or after 6 April 2016, they need 35 qualifying years for a full state pension. If they have less than 35 qualifying years but at least 10, they will receive a reduced state pension.

A qualifying year is secured either through the payment of Class 1, Class 2, Class 3 or Class 4 National Insurance contributions or the award of National Insurance credits. National Insurance credits are awarded in various situations, such as where a person claims child benefit. From 1978 to 2010, a scheme known as Home Responsibilities Protection (HRP) operated to reduce the number of qualifying years that a person with caring responsibilities needed in order to qualify for the full state pension. HRP was replaced by National Insurance credits from 2010.

Following a review by the Department for Work and Pensions, historical issues came to light with the recording of HRP on entitled individuals' National Insurance records. From May 2000 it became mandatory for claimants to provide their National Insurance number when claiming child benefit. Where a claim for child benefit was first made before May 2000 and the claimant did not provide their National Insurance number when making the claim, the HRP to which they were entitled may not have been recorded on their National Insurance record. This may mean that they receive less state pension than they are entitled to receive.

Last autumn, HMRC started sending letters to people who they believed may have been affected by this issue. However, anyone who has not received a letter but thinks that, potentially, they may have missing years is urged to check their eligibility online, and claim any years that are missing. This can be done by visiting the Gov.uk website at www.gov.uk/home-responsibilities-protection-hrp.

Where missing years are claimed and the claimant is not otherwise eligible for the full state pension, reinstatement of the missing years will increase their state pension. If the claimant has already reached state pension age, any arrears due to them as a result of the missing years will be paid. However, it should be noted that, as the state pension is taxable, this may mean that there is some tax to pay on the arrears.

CONT ON PG 7

VAT invoice and accounting controls

VAT-registered businesses who use invoice accounting generally account for VAT when invoices are issued and received. HMRC have recently published new Guidelines for Compliance which set out their recommended approach to the compliance process to ensure that VAT is accurately declared by the business. The guidelines can be used to help establish an appropriate tax control framework which identifies and assesses tax risk and has effective controls in place to reduce those risks. The guidelines cover specific areas and also outline good practice in relation to risk management.

Order to cash

The overall objective of order to cash is the timely, complete and accurate recording of transactions and payments. This will cover the placing of the sales order, the dispatch of the goods and the issue of the tax invoice. The guidelines highlight controls which should exist at each stage, including, for example, controls to ensure that sales orders are only processed within customer credit limits, Goods Dispatch Note shipments are accurately and promptly recorded and that the correct tax rates are used on tax invoices.

Procure to pay

The procure-to-pay section of the guidelines covers initiation of purchase orders, the receipt of the supply, the receipt and processing of the supplier's tax invoice and the payment of that invoice. The guidelines set out the controls that should exist at each stage, such as ensuring that purchase orders are only placed for approved requisitions, that supplies are only accepted if they have a valid purchase order, that only invoices that represent goods or services received are posted to accounts payable and that payments are only made in respect of invoices relating to goods and services which have been received.

Employee expenses

The guidelines also outline expected controls in relation to the processes for capturing, authorising and paying employee expenses, highlighting system controls and those relating to the processing of expenses and

CONT ON PG 8

workflow. They also include examples of controls for different types of expenses, such as motor expenses, business entertainment and mobile phones.

Record to report

Record to report refers to the accounting process which involves the collection, processing and presentation of information to provide strategic, financial and operational analysis. For example, data gathered in the general ledger will be used to produce balance sheets, profit and loss statements, cash flow statements, budget reports and management reports. Controls are needed in relation to both the overall systems implementation and the operation of the general ledger.

VAT reporting

For invoice VAT accounting, controls are needed for various purposes, including compliance with Making Tax Digital (MTD) regulations and the provision of VAT reports. This would include, for example, controls to ensure that VAT reporting is MTD-compliant.

Manual adjustments

Manual adjustments may be made for various reasons, for example to consolidate totals from different business functions or systems or to correct errors. The guidelines set out controls which are expected for different types of manual adjustment.

Outsourcing

Controls are also needed where third parties are used to perform parts of the process. The guidelines highlight the controls which are required where functions are outsourced.

Recommended reading

The Guidelines for Compliance (Help with VAT compliance controls (GfC8)) are recommended reading for businesses using invoice accounting for VAT. The business should check that the recommended controls are in place.

TAX DIARY

NOVEMBER

- 1 November 2024 – Due date for Corporation Tax due for the year ended 31 January 2024.
- 19 November 2024 – PAYE and NIC deductions due for month ended 5 November 2024. (If you pay your tax electronically the due date is 22 November 20244.)
- 19 November 2024 – Filing deadline for the CIS300 monthly return for the month ended 5 November 20244.
- 19 November 2024 – CIS tax deducted for the month ended 5 November 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

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.

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

COMPASS ACCOUNTANTS