

TAXANGLES

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COMPASS

ACCOUNTANTS

A newsletter for proactive planning...



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September 2025 Issue

www.compassaccountants.co.uk



IHT charge on unused pension benefits

From 6 April 2027, inheritance tax will be payable where someone's estate at death includes unused pension funds or death benefits. The measure was announced at the time of the Autumn 2024 Budget. It will increase the inheritance tax payable on an estate which includes unused pension benefits where the estate is not sheltered in full by the nil rate bands or by exemptions. Government estimates suggest that of the 213,000 estates with inheritable pension wealth, around 10,500 estates would have a liability to inheritance tax where previously they would not and 38,500 estates would pay more inheritance tax as a result of this measure.

Background

The Government is of the view that pension schemes are increasingly being used as a vehicle to transfer wealth free of inheritance tax rather than simply to save for retirement. This concern was heightened after the removal of the lifetime allowance. Individuals are able to build up unlimited tax-free savings in their pension, while funding their retirement in other ways and passing on their pension pots to their beneficiaries free of inheritance tax.

The inheritance tax treatment of pension schemes is not the same across the board. Non-discretionary schemes, such as the NHS and judicial pension schemes, are treated as part of an individual's estate for inheritance tax purposes. However, where the scheme is a discretionary scheme, as is the case for most UK pension schemes, unused pension funds can currently be passed on after death free of inheritance tax.


New rules from April 2027

From 6 April 2027, unused pension funds and death benefits will be included in an individual's estate on their death, regardless of whether the pension scheme administers or scheme trustees have any discretion over the payment of any death benefits.

However, death in service benefits payable from both discretionary and non-discretionary registered pension schemes will remain free of inheritance tax. The inter-spouse exemption (which applies when an estate is passed to a surviving spouse or civil partner) applies equally to unused pension benefits, as does the exemption for gifts to charities.

Administration

Personal representatives will be responsible for reporting and paying the inheritance tax due. This is a change from the original proposal under which the burden would have fallen under scheme administrators and was made in light of responses received to a consultation on the issue.



Class 2 National Insurance contributions charged in error

The liability for self-employed earners to pay Class 2 National Insurance contributions was abolished with effect from 6 April 2024. Now Class 2 National Insurance is a voluntary charge which self-employed earners with profits below the small profits threshold can choose to pay to secure a qualifying year for state pension and benefit purposes. Where a self-employed earner has profits in excess of the small profits threshold, they receive a National Insurance credit if their profits are between the small profits threshold and the lower profits threshold. If their profits exceed the lower profits limit, they will pay Class 4 contributions.

For 2024/25, Class 2 contributions are only payable where a self-employed earner has profits below the small profits threshold (which for 2024/25 is £6,725) and they have opted to pay Class 2 voluntarily. For 2024/25, voluntary Class 2 contributions are payable at the rate of £3.45 per week; an annual liability of £179.40.

The problem

Some self-employed taxpayers have been charged Class 2 National Insurance contributions for 2024/25 in error. The nature of the error depends on their particular circumstances. Some self-employed earners with profits in excess of the lower profits limit (set at £12,570 for 2024/25) have had a Class 2 National Insurance charge of £358.80 added to their account. This is twice the voluntary Class 2 charge for 2024/25. Self-employed earners with profits in excess of £12,570 are liable to pay Class 4 National Insurance on their profits only.

In some cases, the amount added in error is less than £358.80.

Resolving the issue

HMRC have stated that they have taken action to correct the error where the information that they hold has enabled them to do so. Some self-employed taxpayers have also reported that their Self Assessment calculation (SA302) has been amended to revert to the correct liability initially reported on their 2024/25 Self Assessment tax return.

However, incorrect Class 2 National Insurance letters will continue to be sent out until HMRC have resolved the IT issue in September. Once the problem has been resolved, HMRC will correct the remaining accounts showing a Class 2 National Insurance charge in error. Those affected will be notified when this has been done.

Where a payment has already been made in respect of the incorrect Class 2 National Insurance charge, it will either be refunded or a credit will be added to the taxpayer's Self Assessment account.

Taxpayers have until 31 January 2026 to submit their 2024/25 Self Assessment tax return. Self-employed taxpayers who have yet to submit their return may wish to wait until this issue is resolved before doing so. Where the return has already been submitted, check the calculation and if it is wrong, make sure HMRC correct it.



Information that must be included on a VAT invoice

A VAT invoice is an invoice that contains information required by the VAT regulations. A VAT invoice can only be issued by a business which is registered for VAT. Where a business is VAT registered, they must issue a VAT invoice whenever they supply goods or services that are liable to the standard rate of VAT or a reduced rate to another taxable person. A VAT invoice must normally be issued within 30 days of the date on which the supply was made.

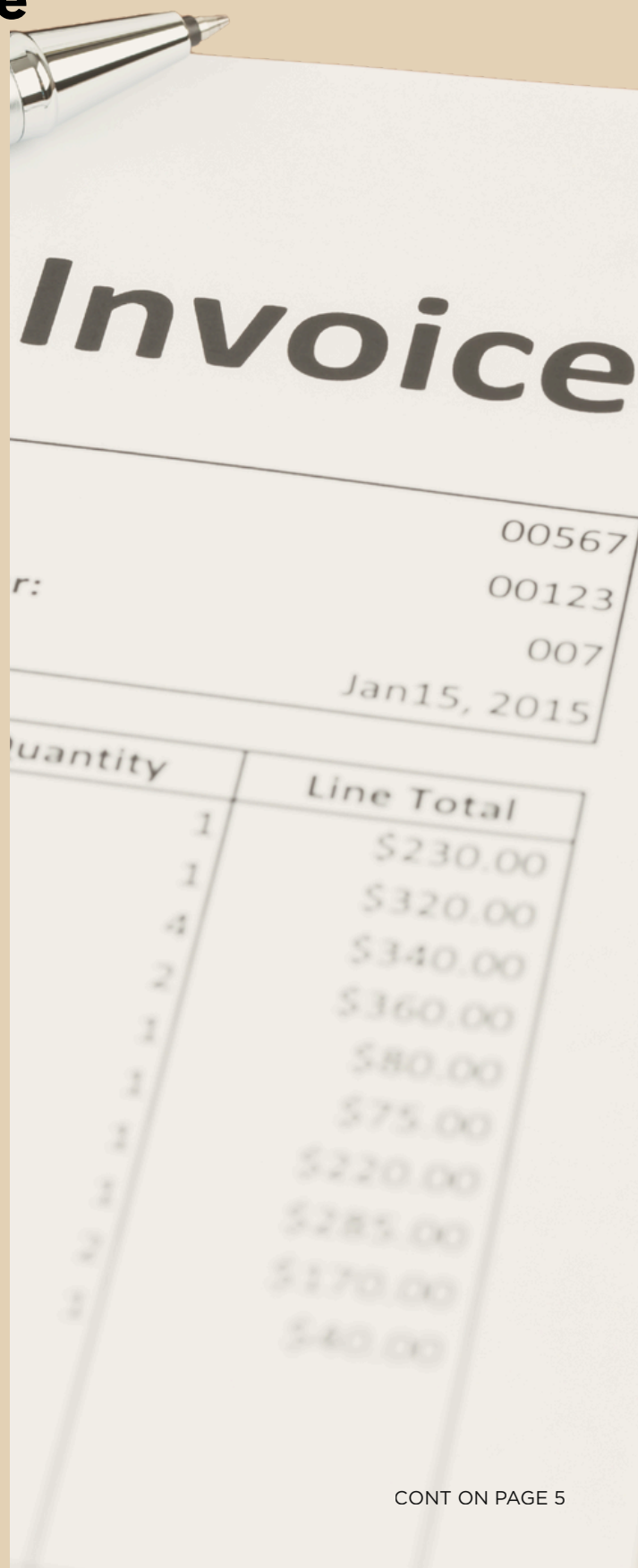
VAT invoices are important and the business must keep a copy of every VAT invoice that they issue. Likewise, they must keep a copy of every VAT invoice that they receive. VAT invoices are the primary evidence of VAT charged and VAT incurred.


Details that must be included

Every VAT invoice issued must include the following information:

- a sequential number based on one or more series that uniquely identifies the document;
- the time of supply;
- the date of issue of the document (where this is different from the time of supply);
- the name, address and VAT registration number of the supplier;
- the name and address of the person to whom the goods or services are supplied;
- a description sufficient to identify the goods or services supplied;
- for each description, the quantity of the goods or the extent of the services, and the rate of VAT and the amount payable, excluding VAT, expressed in any currency;
- the gross total amount payable, excluding VAT, expressed in any currency;
- the rate of any cash discount offered;
- the total amount of VAT chargeable, expressed in sterling; and
- the unit price.

It should be noted that different rules apply where a margin scheme is used and the business should follow the rules of the



A hand holding a pen is positioned over a document. The document features a table with multiple columns of numbers and a bar chart to the right. The background is a blurred office setting with a laptop and a smartphone.

scheme. Where a business based in Northern Ireland sends an invoice to a person in an EU member state, the VAT invoice must also include the letters 'GB' in front of the VAT registration number for cross-border supplies, the registration number of the recipient preceded by the alphabetical code for the relevant EU member state and a reference to the means of transport.

Electronic invoices

VAT invoices may be issued electronically, and electronic invoices offer a number of advantages over paper invoices. Electronic invoicing is the transmission and storage of invoices in an electronic format without duplicate paper invoices.

The information set out above in relation to paper invoices must also be contained in electronic invoices. However, when sending batches of invoices to the same customer, information that is common to the individual batches may be recorded once per batch rather than on each invoice. For example, the customer's full name could be included on the batch header rather than on each individual invoice.

Retail invoices

There is no requirement to issue a VAT invoice for retail supplies to unregistered businesses. If asked for a VAT invoice and the supply is £250 or less, a simplified VAT invoice can be issued. However, if the supply is more than £250, a full VAT invoice must be provided if requested.

Simplified invoice

A simplified invoice can be issued if the supply is £250 or less showing the supplier's name, address and VAT registration number, the time of supply, a description of the goods or services and the VAT rate charged for each, the total amount payable including the VAT shown in sterling and the VAT rate charged. Exempt supplies should not be included in a simplified invoice. Where the value of the supply is more than £250, a full VAT invoice must be issued.

Credit notes

Where a credit note is issued, it must include the same information as the original invoice and sufficient information to identify the original invoice.

Currency

Although the invoice amounts may be expressed in any currency, where there is a positive rate of VAT due in the UK, the total amount of VAT must be expressed in sterling.

Paying sufficient salary to get a qualifying year for state pension purposes

There are various ways in which profits can be extracted from a personal or family company. A popular and tax-efficient extraction strategy is to pay a small salary and to extract further profits as dividends as long as the company has sufficient retained profits.

One of the advantages of paying a salary is to secure a qualifying year for state pension and benefit purposes. A person needs 35 qualifying years when they reach state pension age to receive a full state pension and at least ten qualifying years to receive a reduced state pension. If the director does not yet have 35 qualifying years, it is worth paying a salary which is sufficient for the year to be a qualifying year.

A year will be a qualifying year if an individual has qualifying earnings subject to National Insurance that are at least 52 times the lower earnings limit. Payments of salary and bonus are liable to Class 1 National Insurance. By contrast, dividends do not attract National Insurance.

For 2025/26, the lower earnings limit is set at £125 per week. Thus, it is necessary to pay a salary or bonus of at least £6,500 ($52 \times £125$) for the year to be a qualifying year.

Where earnings are between the lower earnings limit and the primary threshold, which for 2025/26 is aligned with the personal allowance at £12,570, primary contributions are payable at a notional zero rate. This means that the director or employee benefits from a qualifying year for state pension purposes without having to actually pay any primary Class 1 National Insurance contributions.

However, the same is not true for the employer. The reduction in the secondary threshold to £5,000 from 6 April 2025 means that the secondary threshold is now below the lower earnings limit and, unless the employment allowance is available to shelter employer contributions, paying a salary equal to the lower earnings limit will come with a secondary Class 1 National Insurance bill. Personal companies where the sole employee paid above the secondary threshold is also a

director do not benefit from the employment allowance. Consequently, where a salary is paid which is of a level which is sufficient for a year to be a qualifying year for state pension purposes, secondary contributions will be payable. On a salary of £6,500 (the minimum needed for a qualifying year), the associated secondary Class 1 National Insurance bill will be £225 ($15\% (£6,500 - £5,000)$). In a family company where the employment allowance is available, it is possible to pay a salary which is sufficient to secure a qualifying year without an associated secondary Class 1 liability.

Although it is only necessary to pay a salary of £6,500 for the year to be a qualifying year for state pension purposes, if the personal allowance is available in full, it is more tax efficient to pay a salary of £12,570, as the corporation tax deduction on the salary and secondary Class 1 National Insurance will outweigh the secondary Class 1 National Insurance bill.



Checking your tax code

The tax code is fundamental to the operation of PAYE. An employee's tax code provides the employer with the information needed to deduct the correct amount of tax from an employee's pay. There are various types of tax codes depending on an employee's circumstances.

A tax code is typically made up of numbers and letters. Most people will have a suffix code comprising a number followed by a letter. The number in a suffix code indicates how much tax-free pay the individual is entitled to for the tax year – the number is their personal allowance for the year, less the last digit. For example, if a person is entitled to the standard personal allowance of £12,570 for 2025/26, the number in their tax code will be 1257.

The number will be different to this if there are deductions in the employee's tax code, for example, to collect underpaid tax for a previous tax year or to collect the tax due on benefits in kind which have not been payrolled. It may be higher if, for example, the employee makes donations to charity.

The letter in the tax code refers to the employee's situation and how this affects their personal allowance. The following letters may be found in a suffix code:

- L indicates that the employee is in receipt of the standard personal allowance;
- M indicates that the employee has received the marriage allowance;
- N indicates that the employee has transferred £1,260 of their allowance to their spouse or civil partner; and
- T indicates that the code includes other calculations to work out the employee's personal allowance. This may be used where the personal allowance is split between more than one job and/or pension.

For 2025/26 a person in receipt of the standard personal allowance with no deductions will have a tax code of 1257L. A person who has received the marriage allowance and has no deductions in their code will have a tax code of 1383M, while their spouse/civil partner will have a code of 1131N.

There are also special codes. Code 0T indicates that the employee has no personal allowance. It may also be



used where an employee starts a new job and the employer does not have the details needed to give the employee a tax code.

Code BR indicates that all income from this job or pension is to be taxed at the basic rate. This may be the case if the person has more than one job or pension and the personal allowance is allocated fully to another job or pension. Code D0 indicates that all income from the job or pension is taxed at the higher rate, while code D1 indicates that all income from the job or pension is taxed at the additional rate. Similar codes for Scottish taxpayers indicate all income is taxed at the relevant Scottish rate.

If the deductions in the employee's code exceed their allowances, the employee's code will have a K prefix. The number element is additional pay added to their actual pay when working out their tax rather than their tax-free pay.

An S prefix indicates that the taxpayer is a Scottish taxpayer and the Scottish rates of tax apply, while a C prefix indicates that the taxpayer is a Welsh taxpayer.

Emergency codes

If the code is followed by 'W1', 'M1' or 'X', it is an emergency code, for example 1257L M1. The code is applied on a non-cumulative basis. Emergency codes are temporary and are usually updated when HMRC have sufficient information.

Updating a tax code

It is important to check that your tax code is correct. You will see it on your payslip. You can also find it on your HMRC app. If you think that your tax code is wrong, you can update it using HMRC's check your income tax online service (see www.gov.uk/check-income-tax-current-year).

TAX DIARY

SEPTEMBER

1st September - For companies with November year ends Corporation Tax is due

7th September - Electronic Payments of VAT must have reached HMRC

7th September - Electronic Submission of VAT returns deadline

19th September - August's PAYE and Class 1 NIC Postal Payment must reach HMRC

22nd September - August's PAYE and Class 1 NIC Electronic Payment must be cleared to HMRC

30th September - For companies with September 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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