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TAX AND FINANCIAL STRATEGIES 2020/21

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Introduction

The UK economy continues to operate under challenging economic conditions. Meanwhile, Making Tax Digital for VAT now takes effect, and business owners are urged to consider the changes to Entrepreneurs' Relief conditions, and to take advantage of the increased capital allowances Annual Investment Allowance. Here, we provide an overview of these latest developments.

Making Tax Digital for VAT

HMRC has launched its landmark Making Tax Digital (MTD) initiative, which sees a fundamental change to the way in which businesses keep records and report to HMRC. It requires businesses and individuals to register, file, pay and update their information via a secure online tax account.

Under the MTD for VAT rules, businesses with a turnover above the VAT registration threshold (currently £85,000) must keep digital records for VAT purposes and provide their VAT return information to HMRC using functional compatible software. Businesses below the VAT threshold which have voluntarily registered for VAT can opt to join the scheme.

The MTD rules generally apply from the first VAT accounting period beginning on or after 1 April 2019, however, for some VAT-registered businesses with more complex requirements, the rules take effect on 1 October 2019. Included in this deferral category are VAT divisions, VAT groups and firms using the annual accounting scheme.

VAT returns must be submitted to HMRC via an Application Programming Interface (API). Submission can be from API-enabled spreadsheets, software or bridging software. The transfer of data to HMRC, from the mandatory digital records to the filing of the return, must be entirely digital. MTD for VAT is backed up by a system of penalties. For the first year, however, HMRC intends to take a slightly more lenient approach on penalties for the issue of digital links between software products. Businesses are given until at least 31 March 2020 to have digital links in place between software products. HMRC refers to this as a 'soft landing' penalty period.

In the 2019 Spring Statement, Chancellor Philip Hammond confirmed that the government will not mandate MTD for any new taxes or businesses in 2020.

Changes to the Annual Investment Allowance

The majority of businesses are able to claim a 100% Annual Investment Allowance (AIA) on a portion of the expenditure on most types of plant and machinery (except cars). The AIA applies to businesses of any size and most business structures.

The AIA increased from £200,000 to £1 million from 1 January 2019, for a period of two years (complex rules apply to 'straddling' accounting periods). Businesses are urged to time their capital expenditure so as to make full use of the increase.

Entrepreneurs' Relief

A special tax relief, Entrepreneurs' Relief (ER), may be available for those in business, which reduces the tax rate on the first £10 million of qualifying lifetime gains to 10%. In a change to the previous rules, the relief will be available to individuals on the disposal after two complete qualifying years of:

- all or part of a trading business carried on alone or in partnership
- the assets of a trading business after cessation
- shares in the individual's 'personal' trading company
- assets owned by the individual used by the individual's 'personal' trading company or trading partnership where the disposal is associated with a qualifying disposal of shares or partnership interest.

New 5% 'personal' trading company rules

To qualify for ER, the company needs to be an individual's personal company where the individual must:

- be a company employee or office holder
- hold at least 5% of the company's ordinary share capital; and
- be able to exercise at least 5% of the voting rights.

For disposals on or after 29 October 2018, they must also satisfy one of the following tests:

- a distribution test – an individual is entitled to at least 5% of the company's profit available for distribution to equity holders and 5% of the assets available for distribution to equity holders in a winding up; or
- a proceeds test – an individual is entitled to at least 5% of the proceeds in the event of a disposal of the whole of the ordinary share capital of the company.

Your financial planning strategy

In the face of ongoing change, it is more important than ever to have a robust business and personal financial planning strategy in place, to help ensure that you and your family are financially secure and on course to achieve your long-term goals.

We can help with all of your business and personal tax and financial planning needs. For a strategic review of your finances, please contact us.

Personal tax essentials

Personal allowance

Each individual is entitled to his or her own personal allowance (PA) of £12,500 for 2019/20. The PA reduces an individual's taxable income. For those with income in excess of £100,000, the allowance is restricted.

After reducing income by the PA a series of rate bands are assigned first to your non-savings (this may include income from wages, self-employment, property income and pensions), then to your savings income, and finally to any dividend income.

Income tax rates for 2019/20

Non-savings income for English and Northern Irish taxpayers is taxable as follows:

Band £		Rate %
0 - 37,500	Basic rate (BR)	20
37,501 - 150,000	Higher rate (HR)	40
Over 150,000	Additional rate (AR)	45

Welsh taxpayers

From 6 April 2019, the National Assembly for Wales has the right to vary the rates of income tax payable by Welsh taxpayers. The Welsh rate of income tax has been set at 10% and is added to the UK rates, which are each reduced by 10%. This means that for 2019/20, the tax payable by Welsh taxpayers continues to be the same as English and Northern Irish taxpayers.

Scottish taxpayers

However, the following rates and bands apply for Scottish taxpayers (on non-savings and non-dividend income):

Band £	Band Name	Rate %
0 - 2,049	Starter	19
2,050 - 12,444	Basic	20
12,445 - 30,930	Intermediate	21
30,931 - 150,000	Higher	41
Over 150,000	Top	46

Rates that apply across the UK

Savings income

The Personal Savings Allowance (PSA) applies to income such as bank and building society interest. The allowance applies for up to £1,000 of a basic rate taxpayer's savings income, and up to £500 of a higher rate taxpayer's savings income each year. The allowance is not available to additional rate taxpayers.

In addition to the PSA, some taxpayers benefit from the starting rate for savings, which taxes £5,000 of savings income at 0%. This is not available if the taxable non-savings income exceeds the starting rate band.

Dividend income

The Dividend Tax Allowance (DTA) is £2,000. The DTA does not change the amount of income that is brought into the income tax computation. Instead, it charges £2,000 of the dividend income at 0% tax – the dividend nil rate. Like the PSA, the DTA does not reduce total income for tax purposes, and dividends within the allowance still count towards the appropriate basic or higher rate bands. Dividends in excess of the DTA are taxed at 7.5% (BR); 32.5% (HR); and 38.1% (AR).

Case Study

Tina has gross income of £56,000 (made up of £26,000 earnings, £5,000 of interest and UK dividends of £25,000). Her tax liability is £6,825.

	Earnings	Interest	Dividends
Income and gains	26,000	5,000	25,000
Deduct: PA	–12,500		
Deduct: AE			
Taxable	13,500	5,000	25,000
Tax at:			
0% on PSA / DTA	0	500	2,000
20% on	13,500	4,500	
7.5% on			17,000
32.5% on			6,000
Total tax	£2,700.00	£900.00	£3,225.00
Total tax liability £6,825.00			

The 'hidden' 45% and 60% tax rates

The top rate of income tax, for those with taxable income in excess of £150,000, is 45% (38.1% for dividends). The PA is scaled back if 'adjusted net income' exceeds £100,000, being reduced by £1 for every £2 of income in excess of that limit. This means that an individual with total taxable income of £125,000 or more will not be entitled to any PA. This gives an effective tax rate on this slice of income of 60% – higher if you are a Scottish taxpayer paying the Scottish Top rate of tax of 46%. It may be possible to reduce your taxable income and retain your allowances if approached with due consideration, e.g. by making pension contributions or Gift Aid donations. Contact us now for advice on minimising the impact of the top tax rates.

Business tax strategies

Starting a business

Starting a business is an exciting and challenging experience, and one which also carries a fair degree of risk. During the start-up phase you will need to make all kinds of decisions that could be critical to the long-term success of the enterprise. You'll need to consider such things as: the type of business and its attributes; your target market and competition; profit potential and how you will extract those profits; the rate of business growth; and the impact of running the business on your personal life. At some point, you'll also need to consider how you will exit the business when the time comes, and realise its value. We can provide expert, tailored advice and help you avoid the common mistakes.

Writing a business plan – One of the first things you need to consider is your business plan. This is not only for the benefit of potential investors, but to help you stay on the right course in the short, medium and long-term. It should include: the business structure that best meets your needs (such as sole trader, partnership, limited liability partnership or limited company); your intended funding sources; tax-efficient borrowings; whether a PAYE scheme is necessary; and whether the business should be VAT registered.

We can guide you through these important decisions, and help you to complete the appropriate registrations. We can assist with cash flow forecasts, helping you to spot potential cash shortfalls, and provide regular updates so you can monitor your business's performance.

Choosing your business structure – Deciding on the most appropriate structure for your business isn't necessarily straightforward. Sole traders, partnerships, limited companies and limited liability partnerships all have their own pros and cons, with different implications for control, perception, support and costs. For example, careful consideration is needed regarding whether or not to retain personal ownership of any freehold property on incorporation. We can help you to decide on the best structure for your business.

Deciding on a year end – It's also important to choose a year end that suits your business. Is there a time of year when it will be more convenient to close off your accounting records, ready for us? What time of year would be best for stock-taking? Is your trading seasonal? From a tax perspective, choosing a year end early in the tax year for an unincorporated business usually means that an increase in profits is more slowly reflected in an increased tax bill, and over time the delay between earning profits and paying the tax can create a source of working capital for the business. On the other hand, a decrease in profits will more slowly result in a lower tax bill. Speak to us for advice about choosing your year end.

Registering with HMRC – When you start a business, it is important to inform HMRC of your new self-employed status as soon as possible. If and when you take on employees you need to register for and set up a PAYE scheme and accept all the responsibilities and obligations that go with it, including compliance with Real Time Information reporting (and remember for this purpose *you* will most likely be an employee of your limited company, if you incorporate). You will also have to comply with the pensions auto-enrolment obligations, although exemptions apply to director-only companies, so do get in touch for advice in this area.

Please talk to us as soon as you envisage having employees so we can help you set up a PAYE scheme and comply with your payroll obligations, or take on the task on your behalf.

Starting a business – Action Plan	✔
Prepare a robust business plan	
Ensure that you have access to suitable funding	
Check your right to use your chosen trading name	
Choose the right business structure	
Register with HMRC	
Register for VAT	
Register your business name	
Trade and professional registrations	
Choose your year end	
Plan to reduce your tax liability	
Develop your branding	
Involve the family	
Plan to avoid fines and penalties	

Claiming expenses

As your accountants and tax advisers, our job is to help ensure that you benefit from all of the allowances and reliefs available to you. You will pay tax on your taxable profits, so a crucial element of tax planning is to claim all deductible expenses, many of which will be included in your accounting records.

If you are self-employed and carry on your business from home, you can claim tax relief on part of your household expenses, including insurance, repairs and utilities. You may also be able to claim for the cost of travel and accommodation when you are working away from your main place of business, so you should keep adequate business records, such as a log of business journeys. In addition to ensuring that your accounts are accurate, these records may also be requested by HMRC.

With the introduction of Making Tax Digital for VAT, an appropriate computer package is essential to aid concise and effective record-keeping and to enable you to meet your Making Tax Digital and VAT obligations. We can advise you on suitable software to meet your business needs.

You may also wish to consider the voluntary cash basis for calculating taxable income for small businesses, which allows eligible self-employed individuals and partnerships to calculate

their profits on the basis of the cash that passes through their business. Businesses are eligible if they have annual receipts of up to £150,000 and they will be able to continue to use the cash basis until receipts reach £300,000. This is something we should discuss with you in detail if you are eligible. Allowable payments include most purchases of plant and machinery, when paid, rather than claiming capital allowances.

Unincorporated businesses are able to choose to deduct certain expenses on a flat rate basis. However, this is worth discussing before opting for it, as the flat rates are not generous.

Capital allowances

'Capital allowances' is the term used to describe the deduction we are able to claim on your behalf for capital expenditure, such as business equipment, in lieu of depreciation.

Annual Investment Allowance (AIA)

The majority of businesses are able to claim a 100% Annual Investment Allowance (AIA) on a portion of expenditure on most types of plant and machinery (except cars). The AIA applies to businesses of any size and most business structures, but there are provisions to prevent multiple claims.

The AIA increased from £200,000 to £1 million, which applies to expenditure incurred from 1 January 2019 to 31 December 2020. Complex calculations may apply to accounting periods which straddle these dates. It is therefore important to time the purchase of plant and machinery carefully, in order to make the most of the increase.

Businesses are able to allocate their AIA in any way they wish; so it is quite acceptable for them to set their allowance against expenditure qualifying for a lower rate of allowances (such as integral features).

Enhanced Capital Allowances (ECAs)

In addition to the AIA, a 100% first year allowance is also available on new energy saving or environmentally friendly equipment. Where companies (only) have losses arising from ECAs, they may choose how much they wish to carry forward and how much they wish to surrender for a cash payment (tax credit is payable at 19%, but subject to limits).

A separate ECA scheme is available for new electric and low carbon dioxide (CO_2) emission cars (up to 50g/km from 1 April 2018) and new zero emissions goods vehicles (up to 31 March 2021 (corporates) or 5 April 2021 (others)). They still qualify for the 100% first year allowance, but do not qualify for the payable ECA regime.

Writing Down Allowance (WDA)

Any expenditure not covered by the AIA (or ECAs) enters either the main rate pool or the special rate pool, attracting WDA at the appropriate rate – 18% and 6% respectively for 2019/20 (the special rate pool WDA was 8% in 2018/19). The reduction applies from 1 April 2019 (corporates) and 6 April 2019 (others). Again, complex calculations may apply to accounting periods which straddle these dates.

The special rate pool applies to higher emission cars, long-life assets and integral features of buildings, specifically:

- electrical systems (including lighting systems)
- hot and cold water systems
- space or water heating systems, powered systems of ventilation, air cooling or purification and any floor or ceiling comprised in such systems
- lifts, escalators and moving walkways
- external solar shading.

For most other plant and equipment, including some cars (see below), the main rate applies.

A WDA of up to £1,000 may be claimed by businesses where the unrelieved expenditure in the main pool or the special rate pool is £1,000 or less.

Enterprise Zones

The Enterprise Zones in assisted areas qualify for enhanced capital allowances. In these areas, 100% First Year Allowances will be available for expenditure incurred by trading companies on qualifying plant or machinery.

Cars

Currently for cars purchased with CO_2 emissions exceeding 50g/km, the main rate of 18% applies. However, cars with CO_2 emissions above 110g/km will be restricted to the special rate WDA. For non-corporates, cars with a non-business use element are dealt with in single asset pools, so the correct private use adjustments can be made but the rate of WDA will be determined by the car's CO_2 emissions. Remember, cars do not qualify for the AIA.

Buildings

When a building is purchased for business use, it may be possible to claim capital allowances on plant elements contained therein, e.g. air conditioning, subject to certain conditions. A joint election may need to be made with the vendor. Please contact us for further details and advice prior to any purchase.

Draft legislation has been published on a new type of capital allowance, the Structures and Buildings Allowance. This allowance is available on new non-residential structures and buildings. Relief will be provided on eligible construction costs incurred on or after 29 October 2018, at an annual rate of 2%, on a straight-line basis.

2020/21
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