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How much tax should we all pay?

2012 saw tax avoidance hitting the headlines: celebrities involved in schemes to shelter their income, public officials being paid through personal service companies to avoid PAYE, and multinational companies shuffling their profits into different countries to reduce their UK tax bills. The Chancellor has announced a crackdown on avoidance, putting more of HM Revenue & Customs' resources into tackling the 'problem' – and some of the avoiders have taken fright at the publicity and promised to change their ways.

All this raises an old question: what's the 'right amount of tax'? Governments create tax reliefs to encourage people to do things – invest in businesses, provide for their old age, give to charity. If you do these things, surely you are being a good citizen, not someone who should be scolded by politicians.

Everyone has to make their own personal decision about how far they will go to reduce their tax bill. This newsletter sets out a number of plans that even HMRC wouldn't object to – they involve straightforward use of the reliefs that the law provides, for the purpose the law intended. They aren't the 'aggressive tax avoidance' that Mr Osborne attacked in his Autumn Statement. There are ideas here that most people – not just celebrities, or multinational businesses – can use to save tax if they want to. Tax rules change all the time, so plans that have made sense in the past may need to be reviewed. But in any case, we recommend an annual review of your tax affairs to see if you are paying more than is necessary, and if what you have done in the past is still appropriate.

The Chancellor now says we will take until 2018 at least to recover from the economic shocks of the past few years, so we can expect HMRC to be even keener to collect whatever is possible. Under self-assessment, last year's return must be submitted and the liability settled by 31 January: between then and the end of the tax year (5 April) is a good time to take stock and make sure that you are as well defended against the taxman as you can be.

Of course, the best plans are not hurried – the last day of the tax year, when most plans ought already to have been implemented, is not the best moment to consider them for the first time. If you think ahead and act in good time, you can save money.

Some of the ideas in this newsletter stay the same from year to year; some change a little; some are completely new. This year, the introduction of Real Time Information is a major new challenge. Of course, the precise circumstances of each individual have to be taken into account in deciding whether any particular plan is suitable or advantageous – but these suggestions may give you some ideas. We'll be happy to discuss them with you in more detail. ●

A good start for VAT

When you are starting or growing a business, getting your VAT registration right is very important. You don't usually have to register until you have made sales of £77,000. If you register before you have to, you have to account for VAT on sales that could have been VAT-free. If you register later than the law requires, you can suffer a penalty.

Unregistered traders are supposed to check that £77,000 limit at the end of every month, and have to act within 30 days if they go over. If you only think about your accounts once a year for income tax purposes, at least be aware of the level of sales – and if you are suddenly very busy, don't let it distract you from the possibility that you might need to tell the VATman.

You might want to register before you are required to so that you can claim back VAT on start-up expenses. You can lose out if you incur VAT too long before the date you put on your VAT 1 registration application, because there are time limits on what you can claim back. You also can't change the date once you've submitted the application – so it's very important to plan ahead and decide when you might want to, and when you might have to, register for VAT. ●

ACTION POINT!
Are you running a business that isn't registered for VAT?

Splitting gains

Most people have an annual exemption for capital gains tax (CGT) of £10,600. You can only use this exemption if you dispose of something and realise a gain in the tax year. You can't transfer an unused exemption to a different tax year or surrender it to any other person.

Say you make a gain of £60,600. After your annual exemption is deducted you will pay CGT of £14,000 (28% x £50,000). If you can split that gain into chunks of less than £10,600, realised over six tax years, you will pay no CGT.

If you have a portfolio of investments, it's common for your investment manager to sell some near the end of the tax year to trigger capital gains or losses, and reinvest the proceeds in something else. There's a cost in commission, but the tax saving is almost certainly much greater.

It's important to make sure your investment manager knows if you have realised gains on other assets. If you've used up your annual exemption elsewhere, the switching plan won't save you any tax. ●

ACTION POINT!
Are you taking full advantage of the CGT exemption?

Company cars

If you drive a company car you are taxed on a percentage of the vehicle's original list price, set by reference to its CO_2 emissions rating. This taxable benefit has increased over recent years and it will carry on rising every year until at least 2017.

Say your car has CO_2 emissions of 157g/km. In 2012/13 the taxable benefit is 22% of its list price, but this rises to 23% in 2013/14, and increases by leaps every year to 28% in 2016/17. So although you don't change your company car, and the vehicle actually loses value over time, you are taxed on a higher amount each year. This tax increase also applies to low-emissions cars, and even zero-emissions cars are taxed on 13% of the list price from 2015/16.

If you are thinking of changing your company car, look at the long term effects of this rising tax on the benefit. You may be better off owning the car yourself and claiming a mileage allowance for business journeys. Your employer can pay 45p a mile tax-free for up to 10,000 miles in a year (and 25p a mile after that). However, a comparison of company and private car also needs to take into account the costs of insurance, repairs, servicing, finance and leasing costs.

The taxable benefit of receiving fuel in your company car for private journeys is calculated using the same CO_2-based percentage applied to a fixed figure (£20,200 for 2012/13, rising to £21,100 in 2013/14). For a powerful car you may pay more in tax on the fuel benefit than you would pay for fuel if you bought it yourself. Ask us to check the sums. ●

ACTION POINT!
Are you paying more tax than your car benefits are worth?

Divide and rule

Income is 'cut up' into tax years to decide whether you are subject to higher rates of tax or not in a particular year. Someone who goes over the income limit one year and has no income the next year pays much more tax than someone with a steady, level income of the same total amount year on year. If your income might fluctuate, it's worth looking at ways to advance or delay the charge on that income in order to even out the tax rates.

The main tax rates are the same for 2012/13 and 2013/14, but the highest rate of 50% is reducing to 45% on 6 April 2013. The thresholds at which tax rates change are important for:

- people with income of £100,000 a year – they start to lose the benefit of their tax-free personal allowance, creating an effective tax rate of 60% on the band up to £116,210 (2012/13) or £118,880 (2013/14);
- people with income of £150,000 a year – they will pay income tax at a top rate of 45% from 6 April 2013.

If you are on the borderline or are likely to cross it next year, it will be worth moving income into whichever year has the lower income. That's so even if you pay tax earlier as a result – 40% now is better than 45% in 12 months.

Income that can easily be moved from year to year includes:

- salary (although PAYE means that the payment of the tax cannot be delayed for a whole year);
- dividends from family companies;
- distributions from discretionary trusts;
- tax charges on cashing in some life insurance policies.

Of course, if the tax charge is going to be the same in either year, then most people would rather pay the tax later. If you receive a slab of income on 6 April rather than 5 April, you may pay the tax on it a whole year later. However, the 20% tax band is being squeezed down from £42,475 in 2012/13 to £41,450 in 2013/14. This means that more people will be paying at 40% next year, and makes the calculations even more important than usual.

It's also possible to claim reliefs for some types of payment in particular years, to make sure that they reduce income taxable at the highest rate. These include pension contributions and charitable donations. There are limits on extra pension contributions, but if you haven't paid the maximum or you're thinking of giving money to charity, and your total income is around the £100,000 or £150,000 thresholds, it's worth checking whether you should put the payment in one year rather than the other. ●

ACTION POINT!
Consider moving income or reliefs around 5 April.

To err is human

If you make a mistake on your tax return, you need to correct it as soon as possible, ideally within 12 months of the deadline for submitting the return. HMRC call such a correction an 'amendment' to the return. Tax returns for 2010/11 can be amended up until 31 January 2013.

If you need to correct your tax return for an earlier tax year, perhaps to reclaim overpaid tax, you can do this by writing to HMRC. But the earliest year you can now claim for is 2008/09, and those claims must reach HMRC by 5 April 2013.

Where HMRC discovers the error first, penalties and interest may be due. Penalties are levied for careless errors, or deliberate mis-statements. It's a tough call trying to prove you took reasonable care (i.e. you weren't 'careless') when completing your tax return, given that you still made a mistake.

Any penalty can be reduced if you deal with the mistake swiftly. You need to disclose it to HMRC as soon as the error comes to light, explain the reason behind the error, and pay the correct tax without delay. If the error was the result of a careless mistake, your 'unprompted disclosure' and full co-operation can reduce the penalty to zero.

Failing to deal with an error is likely to increase the level of penalty if HMRC find out about it later. So it's important not to brush things under the carpet – if you think something may have gone wrong, it's best to face up to it and take advice on how to put things right. We can only help if we have all the available information, so it's important to put us in the picture. ●

ACTION POINT!
Are you satisfied that your tax returns are accurate?

A matter of interest

Tax relief on interest paid is available on business loans, or loans to buy property for renting out. Although the terms and interest rates for such 'business-related' loans may be different from a domestic mortgage, the tax relief for a top rate taxpayer can reduce the cost to half of what it would otherwise be. If you achieve 50% tax relief on interest paid at 8%, this is less than paying 100% of interest paid at 6%! If the rates and terms are the same for two loans, tax relief is a pure advantage.

If you are going to pay down your borrowings, look at the net cost after tax relief rather than the gross. You might want to reduce 'private' borrowings, even if the interest rate is lower, before you pay off loans on which you get tax relief. ●

ACTION POINT!
Review your borrowings to see if tax relief can be obtained.

Season of good Will

You can't take it with you, as the saying goes. When your time is up your relatives need to sort out your affairs. This is a very stressful time, but you can make it easier for those you leave behind by having a clear and up-to-date Will, which has been drafted with tax in mind.

This is particularly important if the total value of your assets, including your home and any insurance policies that pay out on your death, will exceed £325,000 – the current starting point for inheritance tax (IHT).

There are a number of standard measures you can take to save very significant amounts of IHT. For example:

- review who will receive proceeds from your life assurance and pension policies – if your executors are entitled to the money on your death, there will be unnecessary IHT to pay;
- give away surplus assets as early as possible – those gifts will fall out of the IHT calculation completely if you survive seven years after the date of the gift;
- make regular gifts out of your surplus income rather than accumulate income to make a big legacy on your death – the small lifetime gifts often do not attract IHT, while the big legacy is likely to cost 40% in tax;
- leave at least 10% of your chargeable estate to charities and reduce the IHT charged on the balance of your estate to 36%.

This last reduction in the tax rate – introduced in April 2012 – means that you can leave nearly as much to your beneficiaries as if they received the whole estate, while making a generous bequest to good causes. The 10% is based on the taxable estate, not the whole of your assets, so you can reduce your IHT rate for a surprisingly small charitable bequest – but you may need a special clause in the Will to make sure your estate qualifies. ●

ACTION POINT!
Have you considered how much IHT you might pay?

This year, next year

If you run a business – as a sole trade, partnership or limited company – the end of your accounting period is an important date for tax planning. Tax can be saved or delayed if you move income and expenditure between accounting periods. This is a good time to review your plans for purchases and sales of capital assets or the payment of bonuses and other significant expenses.

Pension contributions must be paid within the company's accounting period to be deductible for that period. A salary payment can be deductible for the year if it is actually paid within nine months of the year end. It's worth thinking about the opportunities and the possible problems around the business and tax year-ends.

There will be big changes to the capital allowances for plant and machinery on 1 January 2013. The annual investment allowance (AIA), which allows immediate write-off against profits of the cost of qualifying capital expenditure, increasess from £25,000 to £250,000. If your accounting period straddles 1 January, the AIA rules are complicated. If you are buying any plant in the near future, it will be worth checking what the tax relief will be and considering whether to move the date of purchase before or after the next accounting date. ●

ACTION POINT!
Review spending plans and likely profit levels before your year-end.

Currency roller-coaster

With currency values uncertain, anyone investing abroad needs a cool head and a strong constitution. It's worth being aware of the UK's chauvinistic tax rule, as well – all capital gains have to be worked out in sterling, using the exchange rates ruling on the day you bought the asset and on the day you sold it. That can make a big difference to your CGT position.

Suppose you bought a French ski chalet for € 200,000 when the rate of exchange was € 1.5 = £1. If you sell it for € 210,000 when the exchange rate has moved to € 1.15/£1, you appear to have made a gain of € 10,000. But HMRC will treat this as a purchase for £133,333 and a sale for £182,608, and they will want tax on the £49,275 sterling gain. The French tax authorities will also ask for tax on the actual gain of € 10,000, but at least that French tax should be available to offset against your CGT bill payable in the UK.

You need to be aware of the problem before you make a sale – you may be able to reduce the tax liability by making use of certain tax reliefs, or by timing the transactions to get a better result, as long as you know what's coming. ●

ACTION POINT!
Plan ahead before selling assets abroad.

Last chance saloon

The taxman will close down a business that can't or won't pay its tax bills. However, where the business is experiencing temporary cash-flow problems he may be prepared to accept payment by instalments under a 'time to pay' arrangement (TTP).

There are conditions: your business must be in genuine financial difficulty, and it must be likely to be able to pay if given more time. However, the taxman won't grant TTP to people who ask again and again, or to those who don't keep their promises. Once you have signed up to a schedule, you must pay every instalment on time. If you miss just one payment they'll demand the whole amount with penalties, surcharges and interest.

It's worth having detailed financial information ready to make a case for leniency. If your business needs to spread payment of a tax liability of £1 million or more, an accountant's report will be required to persuade the taxman to accept instalments.

There are some major concessions: if you agree a time to pay arrangement before VAT falls due, there are no default surcharges to pay. A construction industry business can defer tax without losing its entitlement to be paid gross.

The important thing is to be prepared. You must put a proposal for TTP to HMRC's business payment support service before the due date – don't wait until those final demands arrive. ●

ACTION POINT!
Will you be able to pay your tax as it falls due?

Should VAT be flat?

A simplified 'flat rate scheme' is available for businesses with turnover of up to £150,000. You charge VAT as normal to your customers, but you don't pay all the output tax to HMRC – you keep some instead of claiming input tax on most expenses. That saves the bother of separating out the VAT on your costs – and gets rid of a lot of reasons to fall foul of the VATman.

The amount of tax you have to pay depends on the type of business you are – some rates seem to be generous compared to the input VAT you are giving up, and some are less so. If your business qualifies, it's at least worth doing some calculations, to see if it might save you money, time, or both.

If you have a buy-to-let property, that counts as a business for VAT purposes. Even though you don't charge VAT to residential tenants, if you are registered for the FRS you may have to pay VAT to HMRC on your rental income.

If you are in any doubt whether the FRS is for you – whether you are currently using it or not – we'll be happy to check. ●

ACTION POINT!
Could you save under the flat rate scheme?

Child benefit clawback

From 7 January 2013 child benefit will be clawed back from certain high-income families by a tax called the high income child benefit tax charge (HICBC). Child benefit will continue to be paid to the parent who claims it, but if that person or their partner earns more than £50,000 for the tax year, the higher earner will have to pay the HICBC. This tax charge is only paid by the highest earner of the couple, who may not be the person who receives the benefit. So if you are a high earner, you may be due to pay a tax charge because of benefit paid to your spouse or partner.

It works like this: for every £100 of earnings over £50,000, 1% of the child benefit received by the family is clawed back as the HICBC. If earnings are over £60,000 all of the child benefit is paid back to the taxman.

You can avoid this new tax charge by ensuring that both you and your partner each have income for the tax year below the £50,000 threshold. This can be achieved in some cases by adjusting who gets paid what out of the family business, or who receives investment income. Alternatively the child benefit recipient can elect not to receive the child benefit. However, this election needs to be regularly reviewed if the income of the higher earner drops below £60,000 for the tax year.

There are lots of complications in calculating 'income' for this new tax charge, so talk to us as soon as possible if you want to adjust who receives what in your family. If your income is certain to be over £60,000, you may want to make the election to stop receiving child benefit before 7 January 2013. ●

ACTION POINT!
Consider whether you should elect not to receive child benefit.

Rainy day money

The tax reliefs for pension contributions are there to encourage you to provide for your retirement. Most people struggle to save enough to provide a comfortable income after retiring. Declining annuity rates in recent years mean you have to save even more. For example, a 65-year old retiring today needs a pension pot of £450,000 to provide an annual pension of £25,000. A larger pot is needed for an index-linked pension, or to provide a widow's pension.

You can contribute up to 100% of your current earnings to a maximum of £50,000 (for 2012/13 and 2013/14), and get tax relief on the full amount, but any contribution from your employer must be deducted from that cap. If you have contributed less than £50,000 in each of the last three years you can pay extra in the current year to catch up. However, the cap for 2014/15 will be reduced to £40,000, so if you want to maximise your pension fund, you could consider making extra contributions before 6 April 2014.

Tax relief for personal pension contributions is given at your highest rate of tax, but in two stages: you pay a contribution net of basic rate tax, let's say £800. The pension scheme then reclaims 20% tax from HMRC, which results in a total of £1,000 of investments held in your tax-free pension fund. As a 40% taxpayer you claim an additional 20% tax relief through your self-assessment return (and a 50% taxpayer gets a further 30%). So the investment of £1,000 actually costs you £600 (or £500).

Some employee contributions enjoy tax relief by deduction from pay before PAYE is applied. Some older 'retirement annuity policies' still require the payment of 100% of the premium to the fund, with all the tax relief claimed through self-assessment.

The money is saved up to give you a tax-free lump sum of up to 25% of the fund when you take the pension benefits and a taxable income after that. Although there are big tax breaks in this sort of saving, unfortunately you can't get access to the whole of the tax-sheltered fund on retirement, and that makes it unattractive to some people. You should take advice about the options available.

For those lucky enough still to be in a final salary pension scheme – including many teachers, civil servants and health service workers – the annual limit is measured by comparing your entitlement at the beginning and end of the year. To find the value, you multiply the accrued pension by 16, even though current annuity rates suggest the figure should be higher. Inflation is taken into account, which makes the calculations complicated – but a relatively small increase in salary, multiplied by 16, could put the increase in benefit over £40,000. Members of final salary schemes will have to keep a close eye on the effect of the contributions cap. ●

ACTION POINT!
Do you need to take advice about your pension investments?

Give and save

There are very generous tax reliefs for giving to charity, whether you give cash, quoted shares or land.

Gifts made under Gift Aid before you complete your tax return can reduce the tax payable for the year the tax return covers. For example a gift made on 31 December 2012 can reduce the 2011/12 tax which is due on 31 January 2013, if the 2011/12 tax return is submitted in January 2013.

If you pay tax at 50% in 2012/13, you may want to carry back tax relief from gifts made in 2013/14, as the top tax rate will be cut from 50% to 45% for 2013/14. This carry-back of Gift Aid can also reduce your income used to calculate the clawback of child benefit from 7 January 2013, or the excess income over £100,000 that reduces your personal allowances.

Say you pay tax at 40% and give £800 cash to charity. The charity reclaims the basic rate tax you've paid, £200 (giving it £1,000 in total), and you reduce your top-rate tax bill by £200. Your gift costs you £600, net of tax relief. For a 50% taxpayer the net cost would be only £500.

Giving quoted shares or land produces income tax and capital gains tax (CGT) reliefs. Say you give shares worth £10,000. This generates an income tax reduction of £4,000 (for a 40% taxpayer). If the shares would otherwise produce a gain of £6,000 on disposal, you can save CGT at 28%, that's £1,680. So the charity receives £10,000 for a cost to you of only about £4,320. ●

ACTION POINT!
Do you want to make charitable donations?

Don't be late!

The White Rabbit in Wonderland was worried about being late. You should be too, when it comes to your tax return.

If HMRC has told you to file a tax return you must do so by 31 October for a paper form, or by 31 January for online filing. If you miss either deadline you will get a £100 penalty. This penalty applies even if you have no tax to pay, or are due a tax repayment, for the year the return covers.

The penalties increase substantially if you are 3 or 6 months late with the return, and there are penalties and interest for paying late. A 'reasonable excuse' will get you out of penalties, but HMRC won't be sympathetic to any old sob story. The taxman enforces such charges without mercy as another way of raising revenue. It's much better to know what you need to do and to do it in good time. ●

ACTION POINT!
Are you up to date with your returns and payments?

Unhappy returns

The taxman sometimes seems to believe that the main reason for running a business is to fill in official forms. He wonders how you can be late submitting something to him, when that's the most important task there is!

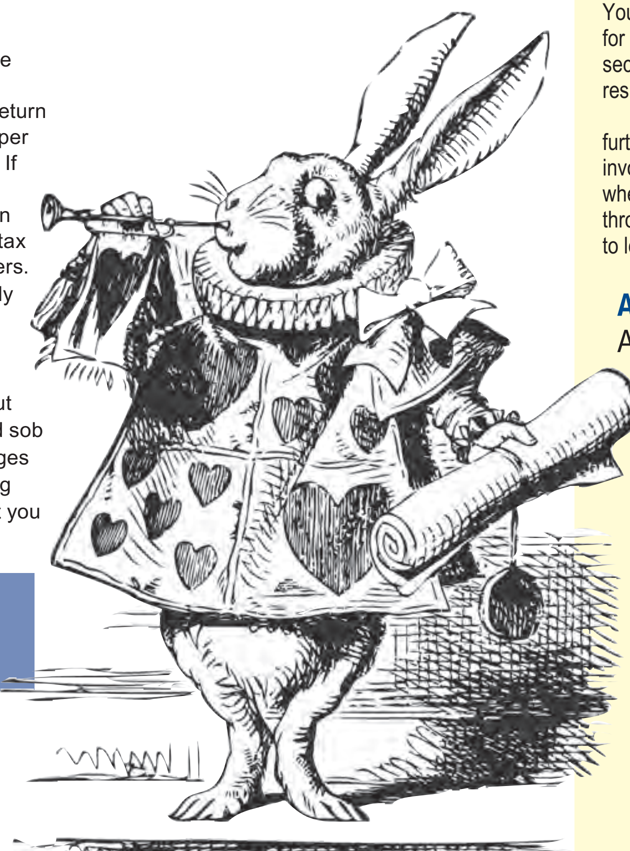
The penalties for lateness apply separately to late forms and late payments. This can end up very expensive, particularly for PAYE which must be paid monthly or quarterly.

The PAYE forms (P35 & P14) have to be submitted once per tax year, by 19 May after the tax year end. You are fined £100 for each month the form is late (more for large payrolls). Under real time information (RTI), you will have to make RTI reports online every time your employees are paid. However, for the first year of RTI – 2013/14 – penalties for late reports won't be imposed if all the information for the tax year is reported by 19 May 2014.

Penalties for late paid PAYE can build up through the tax year. The penalty is based on the number of times the PAYE due arrived late in the tax year: 1% for up to three late payments, and 4% for 10 or more late payments. You are allowed one late payment in a year with no penalty. It is possible to get out of the penalty if you have a 'reasonable excuse'. But it's better to identify the possible problems and do something about them.

If you have received a warning letter from the taxman that PAYE is overdue, don't ignore it. We can help you change your systems to ensure PAYE payments arrive on time. Talk to us before PAYE late payment penalties build up. ●

ACTION POINT!
Do you have difficulty in paying PAYE on time?



Foreign escapes

Just because you move abroad doesn't mean you escape the UK tax net. You need to become 'not resident' in the UK for tax purposes, which is not as easy as merely living in another country. You can be treated as resident for tax purposes in two or more countries at the same time.

For years before 2013/14 you had to make a 'clean break' from the UK, and not return to the UK for regular visits, to be considered not resident. A full-time job working abroad was a pretty sound indication you had left for a permanent purpose, but you still had to limit your visits back to the UK.

If you had no full time job to go to, the taxman would look at your UK ties such as bank accounts, investments, family location, membership of clubs etc. Just counting the number of days in this or that country would not add up to non-residence if the centre of your interests remained in the UK. A number of recent tax cases has shown that the widespread understanding of 'how to become non-resident' was not supported by HMRC or by the courts – HMRC have successfully come after people who had thought their income, and particularly capital gains, were not taxable.

From 2013/14 a series of new rules applies to help you decide if you will be definitely resident or not resident in the UK for a particular tax year. You will be not resident in the UK if you fall into any of these situations:

- Working full-time abroad and present in the UK for fewer than 91 days, with no more than 21 days working in the UK; or
- Present in the UK for fewer than 46 days, and not resident for all of the previous 3 tax years; or
- Present in the UK for fewer than 16 days, and not resident for one or more of the previous 3 tax years.

You'll need to know your residence position for earlier years before you can use the second or third tests to decide if you're not resident for 2013/14.

If these tests are not met there are further hoops to jump through, which involve counting days and depend on where your 'home' is. We can guide you through these new rules if you're planning to leave the country. ●

ACTION POINT!
Are you planning to escape to the sun?

Gains favoured

The recession may have turned capital gains tax (CGT) into a problem many people wish they had, but you could be sitting on unrealised gains that are exposed to tax at 18% or 28%. If the economy recovers – as we hope it will – investments bought now may be showing big gains in a few years.

A lower CGT rate of 10% applies where the disposal qualifies for entrepreneurs' relief (ER). ER generally applies on the sale of your own business or on disposal of shares in your own company. The conditions for ER are complicated and it's worth checking that you are entitled to it if you are hoping to benefit. Don't sell up in the expectation of tax at 10% and be disappointed to find the tax is nearly two or three times as much. There is also a limit of £10 million of gains which can qualify for ER over your lifetime.

The rates of CGT of 10%, 18% and 28% are generally lower than the main rates of income tax (20%, 40% and 50%) so many people try to arrange to receive their investment returns in the form of gains rather than as income. HMRC are aware of this and there are anti-avoidance rules in place that let them charge tax at income tax rates on what the taxpayers think are gains. If you are hoping to pay at the lower CGT rate, it's worth being sure that none of these traps can be applied to you. ●

ACTION POINT!
How much CGT might you pay on your assets?

Winding up the taxman

When a company reaches the end of its useful life, it can be formally liquidated – which carries a cost in professional fees – or dissolved more informally under the Companies Act. The method chosen can affect the tax treatment of any surplus assets to be distributed to the shareholders.

Under a formal liquidation all surplus funds and the return of share capital to shareholders is treated as capital in their hands – liable to capital gains tax (CGT), possibly at only 10%. If an informal dissolution is used, and the shareholders receive distributions totalling more than £25,000, the entire amount is taxed as a dividend subject to income tax. Where the distribution is £25,000 or less, it will be taxed as capital subject to CGT.

The tax rates are so complicated that it's important to take advice on which treatment you would prefer, and then on which tax treatment is possible.

If you have large accumulated profits in a company that you are hoping at some point to extract subject to CGT rates rather than income tax, you will need to consider alternative plans to minimise the tax charge. ●

ACTION POINT!
Do you own a company with accumulated reserves?

Gimme a tax break

Contributions to most tax-favoured investments are capped for each tax year. The limit for Individual Savings Accounts (ISAs) is £11,280 in total, rising to £11,520 in April 2013. Up to half of this can be held in a cash ISA, or the whole amount can be invested in stocks and shares.

If you want to invest on behalf of your children aged under 18 you can open a junior ISA for each child who doesn't have a child trust fund (CTF) account. Anyone can deposit up to £3,600 into the child's junior ISA in 2012/13 (£3,720 in 2013/14).

There's no income tax or CGT on profits arising while the money is held in any type of ISA. You can switch from one investment to another within the ISA and keep the tax advantages, so you can build up an investment portfolio of a substantial value over a number of years. However, if you take the money out of your fund in order to spend it, you have to start again with investments of no more than the annual limit each year.

If you are happy with greater risk, and want potentially higher returns, you can invest in small trading companies under the following schemes within these limits in 2012/13:

- Enterprise Investment Scheme (EIS): £1 million
- Venture Capital Trust (VCT): £200,000
- Seed Enterprise Investment Scheme (SEIS): £100,000

Income tax relief is given at 30% of the amount invested under the EIS or VCT, and at 50% for investments under SEIS. 30% relief effectively reduces the cost of investing £10,000 to £7,000; the SEIS reduces the cost of investing £10,000 to £5,000. Also for SEIS investments you can eliminate tax on capital gains made in 2012/13 where the gain is invested under SEIS in the same tax year. These various tax reliefs won't turn a bad investment into a good one, but it will make a good one better and will reduce the risk involved in investing – if you are a higher rate taxpayer with a capital gain of £100,000 in 2012/13, putting that £100,000 into SEIS will only cost you £22,000 after tax relief of 50% (income tax) and 28% (CGT).

Of course, you need to take proper advice on where to put your money, as well as understanding how it will reduce your tax bill. If you are thinking of investing in one of these schemes, you may want to do so before 5 April to maximise the benefit – the CGT break for SEIS only applies up to 5 April 2013. ●

ACTION POINT!
Do you want to top up your investments?

Good company?

Corporation tax rates (20% and 24% – falling to 23% in April 2013) are lower than the top rates of income tax (40% and 50%), so company owners may save money by leaving their profits in the business. A small company pays tax at 20%, but the owners will pay more tax on the profits when they are paid out to them. Owners of unincorporated businesses (sole traders and partners) pay tax and national insurance (NICs) on all the profits the business makes whether those profits are left within the business or not.

NICs amount to an extra tax on salaries and business profits. Sole traders and partnerships can reduce the impact of NIC by forming a company and paying dividends on top of a small salary – dividends are not NICable. This is a complex decision, which should not be taken on tax grounds alone. There are more forms to file every year when running a company than an unincorporated business, but the tax savings may outweigh that.

There are alternative ways of taking money out of a company, but they can't all be used in the same circumstances. Dividends can only be paid where there are accumulated profits in the company. A salary can be paid even if the company is making a loss, but a salary over the NI threshold of £7,605 (2012/13) will carry NICs. So the best course of action can change from year to year.

To maximise the amount you can take out from your company and minimise the tax charges, take some expert advice before the tax year end. ●

ACTION POINT!
What's the best way to get profit out of your company?

Do I have to pay that?

If you are self-employed you will pay most of your tax through self-assessment. This normally involves making two payments on account (POA) on 31 January during a tax year and 31 July after the end of it.

For the 2012/13 tax year POAs are due on 31 January and 31 July 2013. These amounts are based on the tax liability reported in your 2011/12 self-assessment tax return. If your final 2012/13 tax is more, you pay the rest on 31 January 2014. If your liability drops, you'll get a repayment when you send your 2012/13 return in – but you'll be out of pocket in the meantime.

It's possible to claim to reduce the POA to half your estimated current year tax before you send in the tax return. You don't need a precise calculation, but you can usually tell when POA will be much too large.

Say your business has had a bad year in 2012/13, or you've taken a job that's taxed under PAYE and so reduced your self-employed income. These factors could mean the tax due under self-assessment for 2012/13 will be lower than for 2011/12. It's worth reducing your POAs so the money is in your bank account rather than theirs. ●

ACTION POINT!
Is your tax bill for 2012/13 likely to be less than last year's?

Records checks

The taxman is determined to crack down on businesses that don't keep adequate business records, and cash-based businesses are considered the highest risk.

There's a new inspection regime. It starts with a letter from the taxman telling you to expect a phone call. You can step out of the process by referring the caller to us. You shouldn't get a black mark for doing so: the taxman is required to deal with us as your tax agents if asked.

If you take the call, you'll be asked questions from a computer-generated script, which only accepts a limited range of answers. For example: How many purchases are in cash? Answers accepted: none, a third, half or more.

The answers you give determine whether the taxman regards you as posing a low or a high risk of having inadequate records for filing accurate returns. HMRC may then send you guidance on how to keep better business records, or an inspector to look for what you might be doing wrong. If the taxman wants to inspect your records, please ask us to be present for that visit.

If you 'fail' the inspection you will be told how they think you should improve, and you'll get another visit in 3 months to check whether you have acted on the taxman's advice. A second failure will result in a fine. ●

ACTION POINT!
Are your records up to scratch?

Selling abroad?

In difficult times, it makes sense to look for new markets. If you are VAT-registered, new markets may come with new complications in the paperwork, and it's worth making sure that you are up to speed on the rules.

If you sell goods to business customers elsewhere in the EU, you are usually allowed to zero-rate the sale – you charge no VAT, but you can still recover any input tax on related costs. But you need to be able to show that the customer was registered and the goods left the country. HMRC has suffered from a large number of fraudulent claims in relation to EU trade – typically, but not exclusively, in relation to mobile phones and computer chips – and they are understandably suspicious if the papers are not in order.

If you buy goods from businesses elsewhere in the EU, you have to give them your VAT number to obtain the purchase free of foreign VAT, and then you account for UK VAT in Box 2 of your VAT return.

International purchases and sales of services are subject to different rules again – the result may be similar to the above, but the procedure and the detailed requirements are different.

If you are selling goods or services to businesses in the EU, you will need to complete an EC Sales List every quarter (or monthly, if you sell £35,000 of goods a quarter) giving the customers' VAT numbers and the value of sales. If you exceed higher limits for purchases or sales of goods, you'll need to complete supplementary statistical declarations (intrastats).

Imports and exports are different again. Anyone putting their toes into a foreign market-place needs to be able to deal with a host of problems, and HMRC's requirements are probably not the worst of them – but they're not the least either.

There's some general information on the HMRC website, but it's important to consider exactly what your business needs to do to comply with these rules. We can help. ●

ACTION POINT!
Do you buy or sell goods or services to or from other countries?

Real Time Information

Real Time Information (RTI) is a new way of reporting pay and deductions under PAYE. Under RTI you'll have to send an online report to HMRC each time you pay your employees – that may be more frequently than you currently run the payroll.

Most employers will have to operate RTI from 6 April 2013, unless another date has been agreed with HMRC. In February 2013 HMRC will start to issue 'invitations' to employers to join RTI from a specified date. You must start to use RTI from the date directed.

RTI is a computer-driven process. You need to check whether your payroll software will be RTI-ready from April 2013. Don't assume it will be.

The free HMRC 'Basic Tools' payroll software will work under RTI, but only for up to 9 employees. Any complicated pay situations such as net pay arrangements for pension contributions will be beyond its capability.

If you use a payroll bureau, talk to them about the costs under RTI. You'll have to report more information for each employee, and you may need to run the payroll more frequently, as advances of salary need to be reported when paid. We can help you with your payroll processing.

RTI has two functions – to report employees' pay and deductions to HMRC, and to report net pay and hours worked to the Department for Work & Pensions, to support claims for Tax Credits and Universal Credit. You'll need to report the normal weekly hours worked by each employee, split into bands (up to 15.99 hours; 16 to 29.99 hours; 30 hours or more; other).

In addition the following details are needed for every employee: NI Number, surname and forenames, date of birth, gender.

If one or more of those items is missing, don't enter default numbers, dates or made-up names like 'Mr Dummy'. As long as the other information is accurate HMRC should be able to trace the person through the system.

Every employee has to be included in an RTI report, even if the worker doesn't earn enough to pay tax or NI.

This is the biggest change to PAYE since it was introduced in the 1940s, and every employer will have to take care to make the changeover efficiently and without creating problems with HMRC. Please talk to us as soon as possible about how we can help your business meet the RTI challenge. You have just a few months to get ready. ●

ACTION POINT!
Are you ready for RTI?

Too much NIC?

If you have more than one employment, or an employment and a self-employment, you could end up paying too much in National Insurance Contributions (NICs).

Everyone has a zero rate band where no NICs are paid. This is up to £7,755 for 2013/14. So if your second job or self-employment produces income within that zero band, you don't really have a problem (although you may have to pay Class 2 NICs at £2.70 per week if you are self-employed as well as employed). The zero threshold for Class 2 NICs is £5,725 (for 2013/14), and if your profits are below that threshold, you have to apply for exemption rather than getting it automatically.

Big overpayments of NICs can occur if both of your jobs bring in income over £7,755. In that case, you could be paying the higher rate of NICs (12% for employees, 9% for self-employed) on income from both jobs. To avoid this happening you can apply to 'defer' NICs on one job, and pay the correct NIC on the combined income after the end of the tax year. This limit may already be applied correctly, but it's worth checking.

Your deferment application needs to be sent to HMRC before the start of the tax year. It's always easier not to pay NIC than to get it back after overpaying! ●

ACTION POINT!
Do you multi-task?

Tax-free benefits

The taxman usually wants a slice of any benefits provided by an employer to employees – particularly if they are directors of their own limited company. But there are quite a few benefits that are tax-free by law, and so if your employer provides them, that's cheaper than paying you salary (with tax) for you to buy the goods or services yourself. There is a long list of possibilities, but here's a selection:

- pension contributions up to £50,000
- childcare vouchers of up to £55pw (for basic rate employees – lower amounts for higher rate taxpayers);
- one mobile telephone where the employer owns the phone;
- vans where the private use is restricted to home-to-work travel;
- loan of a bicycle and safety equipment for commuting;
- health checks for employees or members of the household;
- eye test and lenses where work involves using a computer;
- 45p per mile mileage allowance for business use of your own car;
- annual party costing up to £150 per person attending. ●

ACTION POINT!
Can you benefit from these?

Transfer window

Income tax is collected on slices of an individual's income. The first slice is tax free – that's £8,105 (for 2012/13), more if you were born before 6 April 1948. The next slice of £34,370 is taxed at 20%, the next £115,670 at 40%, and anything extra at 50%. Dividends are taxed at slightly different rates.

The problem is that the slices of income are calculated per person, not per family, when in most families the income is shared, irrespective of who earns it.

Take two families with two young children, who claim child benefit of £1,752.40 per year.

In one, H and W each earn £45,000. They pay about £12,120 in tax and NIC each, leaving the family with £65,760 net income plus the child benefit of £1,752.

In the other couple; H earns £90,000, and W has no income. H pays about £31,020 in tax and NIC, leaving the family with net income of £58,980, and from 7 January 2013 onwards the family's child benefit will be clawed back in full. That will be £438 in 2012/13 and £1,752 in 2013/14 – payable by H, unless W chooses not to receive the benefit.

The figures show that it makes sense to transfer some income from the high earner to the lower earner in order to take advantage of the tax free and lower taxed slices of income. This is not always easy to do, but the following methods are possible:

- an outright gift of savings and investments which produce taxable income;
- putting savings and investments into joint names and sharing the income;
- employing the spouse in a business;
- taking the spouse into partnership.

HMRC can challenge some of these if they think the transfer is not genuine – it's important to take advice to be sure that the plan will work.

Capital gains are easier to pass on for tax. If you are likely to realise a gain above your annual exemption (£10,600), you could transfer the asset to your spouse first and save up to £1,908 (if you are a basic rate taxpayer) or £2,968 (if you pay income tax at 40% or 50%). ●

ACTION POINT!
Can you transfer income to reduce your family's tax, and save your child benefit?

NIC and pensions

All large employers are now required to enrol their employees in a quality workplace pension scheme. This so-called auto-enrolment is gradually being extended to smaller businesses. Those employing fewer than 30 people will have to auto-enrol their employees from June 2015 onwards. As an individual employee you can opt out of joining if you wish, but you should consider what you may be giving up.

If you join a workplace pension scheme, you can contribute from your salary and get tax relief. However, your salary is subject to NIC (at 12% and 2% above £42,475), and that doesn't get reduced by pension contributions that you pay.

It makes a lot of sense for your employer to pay directly into a pension fund on your behalf to avoid the NIC. You could agree to reduce your basic pay rate and increase employer contributions instead. This is known as a salary sacrifice. This must be done properly to make sure that HMRC can't argue there was 'really' a payment to you anyway – it's worth taking advice if you are going to substitute employer pension contributions for pay. ●

ACTION POINT!
Do you pay into an employee pension scheme?

Longer holidays?

Furnished holiday lettings (FHL) can be taxed as a 'trade' rather than as normal letting of property which is treated as investment income.

However, to be a FHL 'trade' each property must be available for letting for 210 days in a year (140 days before 6 April 2012), and must be actually let for 105 days in a year (70 days before 6 April 2012). The actual number of days let can be averaged across a number of properties owned by the same person, but each property must be available for letting for the minimum period individually.

Owners can make a 'period of grace' election, which assumes the property qualifies as part of the FHL trade if it was actually let for the required minimum days in the previous year or the year before that. The election for 2011/12 must be made by 31 January 2014.

Where the entire FHL business ceases – maybe because the conditions aren't met – and the properties are disposed of within three years, it should be possible to enjoy Entrepreneurs' Relief. This ensures CGT is charged at only 10% on the gain – provided that the disposal is timed correctly. ●

ACTION POINT!
If you own holiday lets, do they qualify as FHL?

This newsletter is written for the benefit of our clients. Further advice should be obtained before any action is taken.