Be Prepared! The new dividend regime

In our autumn edition we gave an example of the changes to dividends from April 2016, in this edition we are going to look at the impact on small business owners.

The changes to the way dividends are taxed are likely to negatively impact on tax paid by small business owners, even the very smallest.

In the past the most usual method of rewarding the small business owner was to take a salary at a level to ensure sufficient national insurance contributions were made and the remainder of the profits of the company were paid out to the owner as dividends. During this current tax year the result of this allowed a small business owner to receive up to £38,950 (split between a small salary and the remainder in dividends) without paying any income tax.

That same small business owner in the same circumstances during the coming tax year will pay a dividend tax of **£1,721.25.**

No matter which way the split of dividends and salary are taken any salary above £8000 will cause both employees and employers national insurance to become payable and at rates of 12% and 13.8% respectively. This would add significantly to the burden on the business owner.

However one irony of this new method of taxing dividends is that the new regime will generate a saving for those who have an income including dividends just above the £100,000 limit where the withdrawal of personal allowances kicks in, for example:

An individual receives salary of £85,000 and dividends of £20,000. For the tax year 2015/16 (because the dividend is grossed up) income for tax is £107,222. Personal allowances lost amount to £3,611 and the tax on the dividend is £5,000.

For 2016/17 the dividend is gross, so that the relevant income is £105,000. The loss of personal allowance is only £2,500. Tax paid on dividends is less by £125 to £4,875. A further £647.44 is saved as a result of the increased personal allowance, giving a saving of £772.44 in total.

There is a similar impact on the High Income Child Benefit Charge for those with income just above the £50,000 limit.

Top tip:

Planning over the first months of 2016 is essential to ensure the most tax efficient method of distributing the profits of the company is achieved.

We are here to help

We can help you by ensuring that you're aware of the changes that will affect you, your family and your business. To find out more about the ways that we can help you, do not hesitate to contact us.

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This is the time of year when thoughts turn to giving and so in this edition of the Pay Less Tax Newsletter we look at the ways to give tax efficiently. It is also a time for receiving and that also includes the amounts that HM Revenue and Customs (HMRC) receive. Following on from the Autumn Spending Review, without careful planning the treasury will be receiving a lot more than you might think!

Selling your valuable personal assets?

For the general infrequent sale of your personal assets the proceeds are, potentially, taxable under the Capital Gains Tax (CGT) "Chattels" rules, although any chattel with a lifespan which can be predicted as less than 50 years is potentially exempt from CGT - unless capital allowances could have been claimed on it.

Chattels are something that you can touch and move e.g. a piece of furniture, stamps, paintings, non-sterling coins and bank notes, antiques, the family silver or a personalised car number plate. Your personal possessions will normally be chattels.

If you invest in valuable objects on an ad hoc basis then the appreciation in value does not generally attract income tax, but be aware that you cannot claim any relief for expenses of ownership, for example insurance or the charge for a safe custody box.

If a succession of transactions and profitable sales take place then HM Revenue and Customs (HMRC) may consider that these items are being bought, held and sold on a trading basis rather than as investments so please make us aware of the scale and frequency of any such undertaking.

If the item sells for less than £6,000 then you do not need to put the item on your Tax Return. However, if the proceeds are more than £6,000 but less than £15,000 then there are special rules which apply to the gain and CGT will be chargeable at either 18% or 28% dependent on the level of income.

If your assets comprise of a set or a collection then they are treated as separate assets unless they are sold to the same person. A set would be any items similar or complementary where taken together the value is greater than if valued separately. Selling the set over a period of years would not avoid the CGT, the gain is taken as the total sale proceeds but then split over the number of tax years.

Even if the money raised from the sale is given to charity, a CGT charge may arise. The most efficient method of ensuring the maximum benefit for the charity is to give the asset itself to the charity thus avoiding any CGT charge.

...or giving away your assets

If you make a gift of a personal asset there are many Inheritance Tax (IHT) exemptions which the gift of a chattel may fall into. However, if the gift is not covered by an exemption and the person making the gift does not survive by seven years, then the value at the time of the gift will be taken into account in calculating the IHT payable at death.

HMRC do have the power to require auctioneers to provide details of chattel sales in excess of £6,000, so it is important when selling any personal items that the chattels rules are considered. The valuation of any gift of a chattel has implications on any subsequent disposal, therefore an open market valuation should be obtained in writing before making the gift.

Top tip:

Please let us know if you have or plan to gift or sell any personal items so that we can correctly advise you.

Inheritance Tax and Giving

For Inheritance Tax (IHT) purposes it is possible to make small gifts which are exempt from inheritance tax of up to £250 in each tax year to any number of different recipients.

The annual exemption is the amount you can give away each tax year that will be exempt from Inheritance Tax. This is currently £3,000 and applies to one gift or a number of gifts up to that amount.

If you wish to make any larger or more frequent gifts please speak to us as there are other exempt gifts, for example, on the occasion of marriage or formation of a civil partnership or gifts out of normal income, gifts to your spouse or civil partner, a political party or charity which may be appropriate.

A time for charitable giving?

A purchase at a charity shop or a few pounds thrown into a bucket will get no tax relief, but a taxpayer can maximise the impact on the charity they support whilst helping themselves to a little tax relief.

Tax relief is given at the taxpayer's highest rate if the money given to a charity is made under the Gift Aid scheme. The donation can be a single donation or a series of donations and includes covenanted payments. The Gift Aid scheme is available to UK residents and to non UK residents providing they pay sufficient UK tax to cover the tax at basic rate on the donation. Claims for the tax relief, if the taxpayer pays higher rates of tax, are made on the Self Assessment (SA) Tax Return or by asking HMRC to change the deductions made through PAYE.

Gift Aid is not available for those giving through Payroll Giving.

To enable the charity to benefit fully from the donation, a Gift Aid declaration will need to be signed by the donor and this action enables the charity to claim the basic rate tax you have already paid on the donation. This makes every £1 donation worth £1.25 to the charity. The charity can claim back 25p for every £1 donated because the basic rate tax is said to be paid on the gross amount of income (£1.25 x 20% = 25p. Deduct that 25p leaving £1 as the net income).

If the individual making the gift is a 40% taxpayer, then the gross income of £1.25 as shown above has 40% tax relief due or £1.25 x 40% = 50p. Deduct that 50p and it leaves 75p as the net income. The basic rate tax relief (25p) still goes to the charity and the individual can claim the extra tax relief (25p) against his or her total income for the year.

You can complete a Gift Aid declaration and can include any donations made in the last 4 years. However as gifts are made out of your **taxed income** and the charity can reclaim the tax which **you have paid**, the declaration must detail any years where you did not pay sufficient tax to cover the amount the charity will want to reclaim. In the above scenario, at least 25p tax must have been paid by the individual for every gift aided £1.

If you are a non-taxpayer, perhaps you only have a state pension or live on income which is not taxable, (e.g. 'tax-free' withdrawals from life assurance policies) then you may well find yourself being asked to pay the tax the charity has reclaimed. We recommend that you only sign a gift aid declaration if you are certain that you pay sufficient tax to ensure the tax man doesn't ask for it back!

Please speak to a member of the team if you are making, or are considering making, charitable gifts so that we can ensure the correct information is entered on your Self-Assessment Tax Return and you have paid the right amount of tax. We will also ensure that you claim any higher rate tax relief to which you are entitled.

New Websites - which tax relief is which?

Most businesses now have a website, which are not inexpensive to set up and run, but to assume that the cost of the website is part of the day to day running costs of the business is not necessarily correct. Often expenditure on website development may be shown in the business' accounts as advertising, marketing or IT costs but this does not necessarily mean that it is allowable as revenue or day to day business expenditure against the profits of the business in the year in which it was incurred.

If the website will directly generate sales, subscriptions, advertising or other income it will normally be regarded as creating an asset. The costs of developing, designing and publishing the website would therefore be capital expenditure - expenditure on an asset of the business, and will generally qualify as plant and machinery for capital allowance purposes. You would receive a percentage allowance given over a number of years rather than an expense against profits in the year in which it was incurred.

Expenditure on initial research and planning, prior to deciding to proceed with development, is normally allowable as revenue expenditure meaning the expense would be given against profits in the year in which is incurred.

Grants and Research and Development Tax Credits

Grants and (Research and Development) R&D tax credits are both ways in which the Government provides valuable financial support for businesses however it is a specialist task to ensure all possible support is claimed.

R&D tax relief is a company tax relief or credit that can either reduce a company's tax bill or, for some small or medium sized (SME) companies, provide a cash payment based on the company's expenditure on R&D.

For there to be R&D for the purpose of the tax relief, a company must be carrying on a project that seeks an advance in science or technology. It is necessary to be able to state what the intended advance is, and to show how, through the resolution of scientific or technological uncertainty, the project seeks to achieve this.

The advance being sought must constitute an advance in the overall knowledge or capability in a field of science or technology, not a company's own state of knowledge or capability.

Your company may be eligible to claim substantial cash back in the form of either a tax credit, if the company is loss making, or a reduction in the corporation tax liability, if the company is profitable. But if an SME has losses in the accounting period they must surrender the enhanced relief in order to receive the tax credits in cash from HMRC.

From 1 April 2015 SMEs can deduct a huge **230%** of their qualifying R&D expenditure which means for every £100 spent the company can claim an **additional £130** on top against the company's profits. Large companies can deduct 130% in respect of qualifying expenditure incurred.

How much **Grant Funding** a business can claim will depend upon whether that business is receiving a state aid grant or a non-state aid grant.

The SME scheme is generous enough to be considered state aid and as a general principle, any company can only claim one piece of state aid per project. Therefore, if a company has received a state aid grant for a project it cannot claim R&D tax relief under the SME scheme BUT it is possible to default to the large company scheme and claim the significantly less generous 30% uplift. So, in summary, if you have received a grant this will not in itself prevent you claiming R&D relief but it may mean that you have to claim under the large company scheme.

Top tip:

Consider these questions in relation to your business:- Does the company undertake the development of new products/processes, employ technical staff, engineers, software developers or scientists, make advancements in its field of work? Is the company aiming to duplicate existing products or processes in an appreciably improved way, create new or improved products? Does the company consider itself technically innovative, spend money on staff costs, consumables and/or sub-contractor costs in order to undertake the development work?

If you can answer yes to any of these questions then please speak to us as it is possible that an R&D claim exists but don't just think about R&D tax relief, think about what grants are available. Cash grants are far more generous that the R&D tax relief itself.

Why not plan to maximise both. Most grants tend to be project-specific meaning they are made to support a company's initiative in a specific, fairly narrowly defined area. While the cost of this project may only be claimed under the large company scheme, there is nothing to prevent the costs of any other projects being claimed under the SME scheme.