Masons
REGISTERED AUDITORS • ACCOUNTANTS • BUSINESS ADVISORS

"your business…
…our passion"

Autumn 2013

financial UPDATE

Time to break away from incorporation?

Introducing disincorporation relief

In this issue:

Contents

Cover image: istock/moodboard_images

New cash basis accounting

New legislation allows smaller businesses to prepare accounts on a cash basis rather than on the accruals basis from 2013/14 for tax purposes. Although introduced as a simplification measure, the new rules have attracted criticism as a result of their complexity.

The cash basis is essentially a money-in, money-out approach. A business using the cash basis only needs to record sales when the money is actually received and payments when the money is actually paid out. The cash basis does not change the rules for the deductibility of expenses, only the time at which the deduction is given. What is more, no account is taken of money owed to the business or that the business owes.

Under the cash basis, there is no need to take account of debtors, creditors, stock, prepayments and accruals, making it much simpler for a business owner without an accounting background to understand and operate. They just pay tax on money that has been received, helping the business manage cash flow. The cash basis is open to sole traders and partnerships whose income is below the VAT registration threshold. This is set at £79,000 for 2013/14. VAT-registered businesses qualify as long as their income is below that threshold. Once a business has opted to use the cash basis, it can continue to do so even if its income rises above the VAT threshold, as long as income does not exceed £158,000. Above this level, the business must leave the cash basis and return to the accruals basis.

The cash basis rules will not suit every business and there are some restrictions. It may not be the best option if a business has losses to relieve against other income in the same year or if it has high borrowings and deductible interest of more than £500 – neither of these are permitted under the cash basis. Certain types of business are also precluded from using the cash basis. A full list is available at www.gov.uk/simpler-income-tax-cash-basis/who-can-use-cash-basis.

Qualifying businesses can switch to the cash basis from 2013/14 by simply starting to use it and ticking the cash basis box on the self-assessment return. Get in touch with us to discuss your options and the various pros and cons for your situation.

When a liability is no longer a liability

You could now be in the position that without actually doing anything, your estate has suddenly increased in value for inheritance tax (IHT). This is because of an unheralded section in this year's Finance Act.

Suppose you have taken out a loan of £250,000 in order to invest in a business valued at £300,000. After a two-year qualifying period, the business could be eligible for 100% business property relief, and it will then effectively be free of IHT. Until now, when you died, the £250,000 would have been deducted against the value of your taxable estate and this would have reduced the amount of IHT due. You would have had the same tax advantage for assets that qualified for agricultural property relief or woodlands relief.

However, from now on, if you have incurred a liability to acquire, maintain or enhance such property that is eligible for relief, this liability will initially be set against that tax free property, with only any excess amount deducted against the general value of the estate. So in the example above, your estate would see no reduction in IHT because of the £250,000 liability.

The loan of £250,000 will be deducted from the value of the tax free business assets, and the effect will be that the estate will now have jumped £250,000 in value. It would make no difference, as is often the case, if residential property is used as security for the loan – it is the actual purpose of the loan that is now relevant. Trusts will also be affected by this change.

The same principle applies where a person incurs a liability in order to invest in excluded property, i.e. overseas property that is owned by someone who is non-UK domiciled or owned by a trust set up by a non-UK domiciled settlor. Excluded property, as the name suggests, is outside the scope of UK IHT. Although the change is aimed at preventing tax avoidance, such as borrowing against UK assets and depositing the funds overseas, it will also affect normal commercial arrangements. For example, someone who is non-UK domiciled may fund an overseas property purchase by taking out a loan secured against a UK property.

Tightening up

There has also been a tightening up of the deduction of liabilities generally. This is in response to the use of contrived debts in various IHT avoidance schemes. A liability will now only be deductible against the value of a person's estate if that liability is repaid after death out of the assets of the estate. There is an exception where an estate does not repay a liability for a genuine commercial reason. Again, this avoidance measure could impact upon quite normal arrangements.

For example, an elderly parent receives a loan from her children, and upon her death the children simply write off the loan because they are the sole beneficiaries of the estate. Because of this new rule, it will now be necessary to go through the motions of repaying the loan so it will qualify as a deduction for IHT.

The new rules will apply to deaths occurring on or after 17 July 2013. The date when the deceased person actually incurred the liability makes no difference to the situation. There will therefore be a retrospective impact on many estates, even where the deceased had no intention of avoiding inheritance tax.

In future, you will need to be careful to show how borrowings have been used, especially where a mixture of spare cash and loans is used to fund, say, a business acquisition and the purchase of other assets, all within a short time scale.

National minimum wage rises

From 1 October 2013, the minimum hourly rate for workers over the age of 20 will increase by 2%, with 1% increases for other workers:

Age	Current	Revised
21 and over	£6.19	£6.31
18 to 20	£4.98	£5.03
Under 18	£3.68	£3.72
Apprentices under 19 or in first year	£2.65	£2.68

Be warned. HMRC strictly enforces the national minimum wage, not just as a result of worker complaints, but also by identifying high risk employment sectors and risk profiling employers. As well as having to pay arrears, enforcement will result in a penalty and there is the possibility of the employer being named.

Time to break away from incorporation?

Until recently, the road to incorporation has been something of a one-way street. There are tax reliefs for businesses that incorporate, but the tax charges on ceasing to be a company can make it costly to reverse the decision. However, for a limited period only, certain companies can now take advantage of a new disincorporation relief.

Incorporation has been tax-efficient for many businesses, as profits can be extracted from companies by way of dividends with the associated savings of tax and national insurance contributions (NIC). However, incorporation brings with it the various extra regulatory and administrative burdens associated with being a limited company.

Fortunately, new legislation has now eased some of the barriers to disincorporation for smaller companies for whom incorporation has lost its shine. Disincorporation relief is available to a company that transfers its business to some or all of its shareholders, provided that the transfer of business is a qualifying business transfer and is made within the five-year period from 1 April 2013 to 31 March 2018.

A qualifying business transfer satisfies the following five conditions:

- The total market value of the qualifying assets (goodwill and interest in any land that is not held as trading stock) is not more than £100,000.
- The business is transferred as a going concern.
- The transfer includes all of the assets of the business or all its assets apart from its cash.
- All of the shareholders to whom the business is transferred are individuals and if they are partners, the partnership is not an LLP.
- Each of those shareholders have held shares in the company for at least 12 months before the business transfer date.

This new disincorporation relief stops two main tax charges arising on the transfer of the company's assets to its shareholders:

> ...For a limited period only, certain companies can now take advantage of a new disincorporation relief...

corporation tax on any chargeable gains arising on the disposal of assets; and corporation tax under the intangible fixed asset rules on the market value of the goodwill of the company's business. However, care should be taken that assets are not distributed to shareholders at less than their market value because disincorporation relief will then not shelter the associated tax charges.

The company and all of the shareholders to whom the business is transferred have to claim the relief within two years of the date of transfer. Once made, the claim is irrevocable. So, should eligible companies be rushing to take advantage of the relief?

Disincorporation allows small business owners to operate as an unincorporated business, enabling them to take advantage of other simplifications available to such businesses, namely the cash basis and fixed rate deductions for certain expenses. Disincorporation relief can also be useful in avoiding the costs of winding up a company.

However, the advantages of remaining a company should not be forgotten. Profits can be extracted as dividends, saving tax and national insurance contributions, and the flexibility over what is extracted can prevent tax becoming payable at the higher personal rates. On the non-tax side, the advantages of limited liability should not be underestimated.

Ultimately, the decision of whether or not to disincorporate should be made with the best interests of the business in mind. Only then does the question of disincorporation relief come into play. We are here to help you make that decision.

Advisory fuel rates on the move

HMRC's updated advisory fuel rates include the first changes to the rates for petrol cars in two years. Rates for diesel and LPG cars have also seen little change during this period, never moving by more than 1p at a time. The latest reimbursement rates where an employee uses a company car for business travel are:

Engine size	Petrol	Diesel	LPG
1,400cc or less	15	12	10
1,401cc to 1,600cc	17	12	12
1,601cc to 2,000cc	17	14	12
Over 2,000cc	25	18	18

New residence test for the internationally mobile

Before this tax year, you could avoid a large income tax liability, for example on the encashment of a life assurance investment bond, if you could arrange to work full-time overseas and become non-UK resident for a tax year.

But this option was not generally available because it was often difficult to establish the necessary non-UK residence status.

However, it is now much easier to arrange for a temporary period of non-residence thanks to HM Revenue & Custom's (HMRC) new statutory residence test, which offers greater certainty. Unsurprisingly, the test comes with anti-avoidance measures. The new rules only apply if your year of departure from the UK is 2013/14 or later, and the old rules are still relevant if you left earlier.

Complex rules

The temporary non-residence rules apply if you have been resident in the UK for at least four of the seven tax years before the year of departure, and you are away for a period of up to five calendar years. Of course it's not quite that simple – anything involving residence seldom is.

Because of the way the complex rules work, a temporary period of non-residence can, in some circumstances, start earlier than the date when a person physically leaves the UK. HMRC use the example of someone who physically leaves the UK on 15 January 2015, but is treated as leaving on 6 April 2014 for the purposes of the non-residence rules. The same can happen when returning to the UK; so depending on the circumstances, the period actually required away from the UK might be less than five years.

If you are away from the UK temporarily, the income and gains caught in the tax net potentially include:

- Capital gains.
- Dividends from a close company.
- Chargeable event gains on both UK and offshore life assurance policies, when they are encashed or mature.
- Certain pension income, for example under flexible pension drawdown.
- Foreign income of a non-UK domiciled person that is taxable on the remittance basis.

Income and gains that arise during a temporary period of non-residence are subject to tax as if they arose in the year the individual returned to the UK. For example, Jerome invested £100,000 in a life assurance investment bond during 2012. He moved abroad for full-time work in February 2014, and returned permanently to the UK in June 2018. During March 2016 Jerome withdrew funds from the bond, and this resulted in a chargeable event gain of £25,000. The gain will be taxed when he returns to the UK.

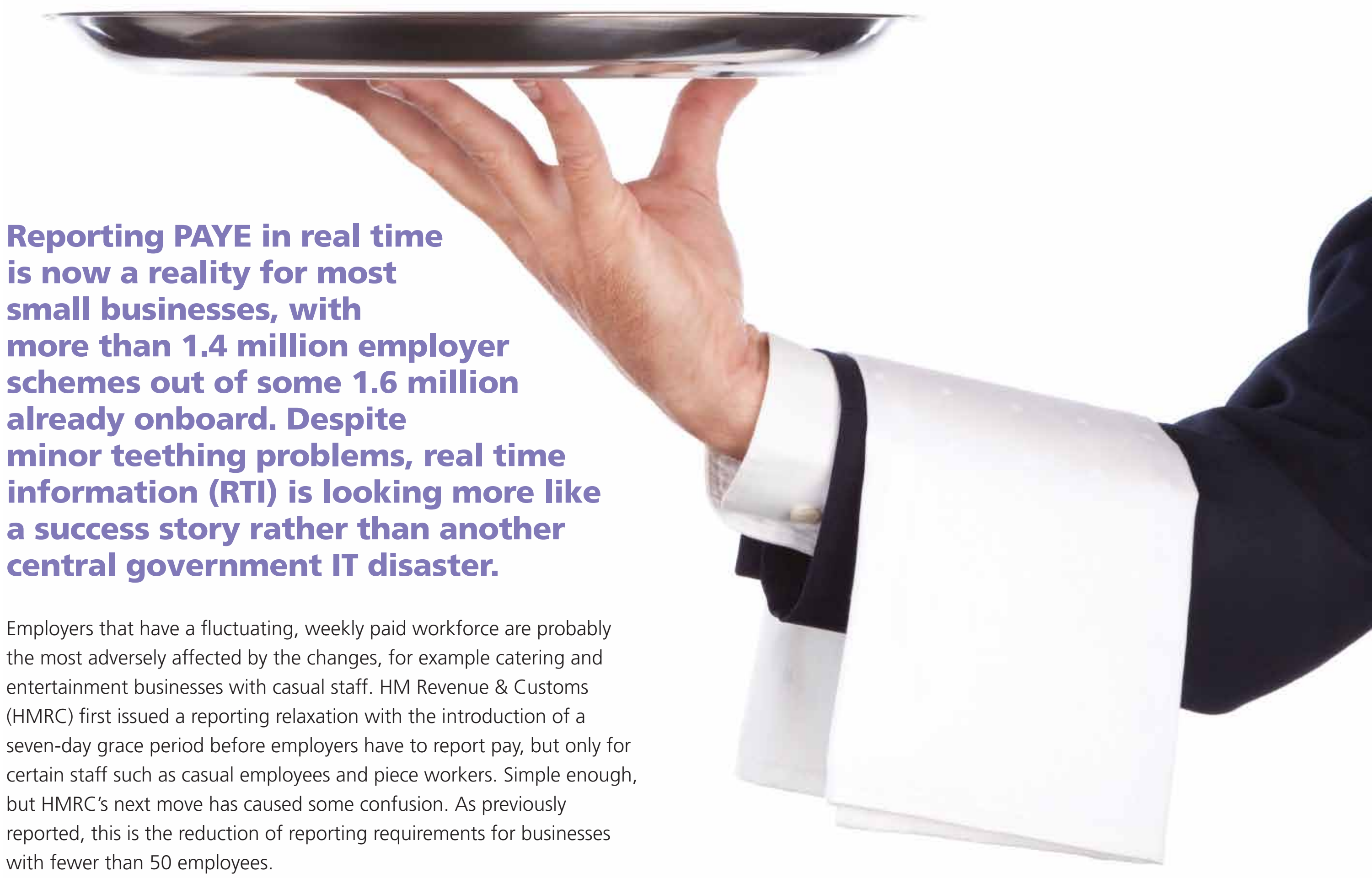
An appealing exit strategy

Despite the requirement to be non-UK resident for more than five tax years to escape capital gains tax (CGT), retiring overseas might still be an attractive exit strategy for company owners. Some business owners build up substantial cash reserves in their companies from accumulated profits in order to avoid paying higher rates of income tax. Such large cash amounts in companies can sometimes preclude being able to claim CGT entrepreneurs' relief. Instead of paying 10% capital gains tax on dissolving such a company, the business owner might well end up paying 28%.

As an alternative, the owner could retire abroad and either keep the company trading while drawing dividends or simply wind it up, and neither the income nor the capital gain would be subject to UK tax. Of course, it would be necessary to check the tax position on these transactions in the foreign country in question.

To help your planning, a trial version of HMRC's residence indicator tool has just been made available and can be found in the Calculators & Tools section of their website. It is subject to HMRC's usual cautionary note about potential inaccuracies.

A real time update on PAYE



Reporting PAYE in real time is now a reality for most small businesses, with more than 1.4 million employer schemes out of some 1.6 million already onboard. Despite minor teething problems, real time information (RTI) is looking more like a success story rather than another central government IT disaster.

Employers that have a fluctuating, weekly paid workforce are probably the most adversely affected by the changes, for example catering and entertainment businesses with casual staff. HM Revenue & Customs (HMRC) first issued a reporting relaxation with the introduction of a seven-day grace period before employers have to report pay, but only for certain staff such as casual employees and piece workers. Simple enough, but HMRC's next move has caused some confusion. As previously reported, this is the reduction of reporting requirements for businesses with fewer than 50 employees.

This relaxation does not amount to a complete removal of the requirements as some employers believe, but it does allow those businesses that pay their staff weekly (or more frequently) to report information once at the end of the tax month. For example, during August, a restaurant can pay its staff weekly, and report the payroll information to HMRC by 5 September at the latest. When it was first announced, this change was intended to apply for just the first six months of 2013/14, but HMRC is now planning to extend it to the end of the year.

Late payments

The other saving grace for 2013/14 is the relaxed penalty regime, especially for those employers who should be reporting PAYE in real time, but who have not yet started. For this year, there are no penalties for late filing submissions. A penalty will only apply if the employee information for 2013/14 does not reach HMRC by 19 May 2014. However, inaccurate submissions could attract a penalty, so strangely enough for the current year, it may be better to be late rather than wrong.

The payment dates for PAYE have not changed, monthly or quarterly, and HMRC has recently issued a warning to this effect. For example, the July payment is due on 22 August if the employer pays it electronically. It should consist of the full payment submission for July, which the employer has to adjust for any corrections or employer payment summary submitted by 19 August. You can check your PAYE position online using HMRC Online Services or by signing up for the PAYE Liabilities & Payments Viewer – but be warned: the figures are only updated twice a month.

Employers should also remember that if they operate a PAYE scheme, they now have to submit payment information for employees earning below the NI lower earnings limit. If all their employees earn less than this amount, no scheme is required – so they will not have to make any submissions – but they will need to monitor the level of their future payments carefully.

Finally, with the added reporting burden that directors of owner/managed companies now face, many of them have decided to opt for an annual PAYE scheme. This avoids having to complete nil payment notifications. As the name suggests, the director is paid in a single tax month each year, and the company makes just one annual PAYE payment to HMRC. Unfortunately, high demand has meant that HMRC is currently unable to process requests to move to an annual basis. An alternative is simply to file several submissions in advance. For example, the company could file July, August and September together before the July deadline – tying in nicely with (the assumed) quarterly PAYE payment.

If you are still struggling to get to grips with real time reporting, then we are here to help.

Clamping down on tax abuse

The general anti-abuse rule (GAAR) has just arrived and some recently issued examples from HMRC help clarify what is considered to be legitimate tax planning. Here are some of the more straightforward cases of what is permissible:

- An employee is given a vintage car instead of a bonus with the aim of avoiding employee national insurance contributions (NICs). The employee does not sell the car but keeps it in their collection.
- A wealthy taxpayer acquires several properties over the course of a few months. Each time the taxpayer elects to make the newly acquired property their main residence and then lives in it for a short period. They then avoid having to pay capital gains tax (CGT) by selling each property within three years of acquisition – the last three years of ownership being exempt from CGT.
- A person settles a lump sum gift into trust using a discounted gift scheme. They retain a 'carved out' income stream from the asset they have given away. If they then die in the next few years, their estate will benefit from a reduction in the potential IHT liability because the asset will be valued at a discount that reflects the carved out income stream.
- A husband makes a gift of some shares to his terminally ill wife. After her death, he inherits them back, and benefits from a tax-free uplift in their base cost for capital gains tax, based on their market value at her death. The impact on the tax liability would be the same even if the gift and death occurred on the same day.

Tax calendar 2013

Every month

1 Annual corporation tax due for companies with year ending nine months and a day previously, e.g. tax due 1 January 2013 for year ending 31 March 2012.

14 Quarterly instalment of corporation tax due for large companies (depending on accounting year end).

19 Pay PAYE/NIC and CIS deductions for period ending 5th of the month if not paying electronically. Submit CIS contractors' monthly return.

22 PAYE/NIC and CIS deductions paid electronically should have cleared into HMRC bank account.

30/31 Submit CT600 for year ending 12 months previously. Last day to amend CT600 for year ending 24 months previously.

File accounts with Companies House for private companies with year ending nine months previously and for public companies with year ending six months previously.

If the date for payment falls on a weekend or bank holiday, payment must be made by the previous working day.

September 2013

6 Deadline to submit a disclosure and make payment under the PSC.

October 2013

1 National minimum wage rates go up.

14 Due date for CT61 return for quarter to 30 September 2013.

31 Deadline for 2012/13 self assessment return if filed on paper.

November 2013

2 Submit employer forms P46 (car) for quarter to 5 October 2013.

December 2013

30 Last day to submit 2012/13 tax return online to have unpaid tax of under £3,000 collected through the 2014/15 PAYE code.

Masons

REGISTERED AUDITORS • ACCOUNTANTS • BUSINESS ADVISORS

337 Bath Road
Slough
Berkshire SL1 5PR

tel: 01628 559551
fax: 01628 559552
email: team@masons-accountants.com
website: www.masons-accountants.com

Partners
M F Chapman
A Jeffries
P J Gorman
N J Gadeke
G A Hook

Please scan for further information