Thursfields
CHARTERED ACCOUNTANTS

paylesstax 2015autumnedition

Dividend Allowance

HM Revenue and Customs (HMRC) announced in their "Dividend Allowance Fact Sheet" published on 17 August that the dividend allowance will use up a taxpayers basic rate band even if the £5,000 dividend allowance results in no tax being due.

This is not as expected, as the term "allowance" usually means something you are allowed. The Treasury appear to want to squeeze every last drop of benefit out of the changes to the taxation of dividends. It is important to note that HMRC's fact sheet states "the allowance will NOT reduce your total income for tax purposes", meaning that more tax may become due than originally thought.

Best demonstrated by an example

In the year starting on 6th April 2016, there is a personal tax allowance of £11,000 and the first £32,000 of a person's income is taxed at 20%. In this year Jim has earnings of £40,000 and has dividend income (which is not part of an ISA investment) of £9,000.

Common sense would tell us that Jim has income of £49,000, he should be able to deduct a personal tax allowance of £11,000 and a dividend allowance of £5,000 leaving £33,000 taxable. £32,000 of which would be at 20% and £1,000 at higher rates of 32.5% or £325.

However what the treasury actually will collect will be 4 times that amount!

Jim's personal tax allowance of £11,000 will leave £29,000 of his earnings to be taxed at the basic rate, leaving £3,000 of the basic rate band unutilised. This is wiped out by the first £3,000 of the dividend allowance, pushing the remaining £2,000 of the dividend allowance into higher rates of tax. The £5,000 dividend allowance has eaten away the remaining basic rate band and into the higher rate band, but with no tax due. The remaining £4,000 of dividend income (£9,000 - £5,000) would be taxed at the higher rate of 32.5%, giving a liability of £1,300.

Talk to us

If you have dividend income and would like to speak to us about the new dividend regime and what it will mean to you, then please contact us and we'll be happy to talk it through with you.

Back to School

With the new school and university terms starting around the country let's look at the position on school fees and education loan payments.

Previously it was the case that if a higher rate taxpayer took dividends to pay their children's school fees, they were charged an additional 25% tax on those dividends. With careful planning in place, the corresponding dividend paid to the child's trust to meet the cost of school fees was free of tax up to about £40,000. That tax-free limit enjoyed by the trust is to be lowered as of **6th April 2016** to £16,000 (which is the £11,000 Personal Allowance for each individual, and the £5,000 tax-free dividend allowance). Any dividend paid to the child's trust fund over and above this is taxed at 7.5%.

However, the cost of **not** planning for school fees has risen considerably.

Where we had a scenario of two children with school fees of £30,000, it would have cost the parent £7,500 in tax to pay these fees. The cost under the new regime would be £8,125 (being the £30,000 fees, less the £5,000 tax free allowance, multiplied by 32.5%).

Careful planning becomes more important if the fee level is higher, the number of children in education is greater, or if the parents' dividend allowance of £5,000 is already taken with dividends paid to themselves.

Talk to us

In short, to create a trust for the payment of fees remains not only a viable option but has become a clear choice for any parent paying school fees. We can help with this planning - please speak to us if you would like more information.

Graduate Loan Repayments

Under the previous coalition government the income limit where students start repaying their loans was increased annually in line with inflation, however this summer the Chancellor announced a five-year freeze on the repayment starting point of £21,000 a year, meaning post 2012 graduates face the prospect of having to start to pay back their fees sooner!

However, it is actually far worse for those graduates who started their course before September 2012. They actually repay their student loans at 9% on income over £17,335! This makes a graduate whose course commenced pre 2012 around £368 per annum worse off!

All graduates start to repay their loans at the rate of 9% per annum of their earnings over their personal pre or post 2012 threshold in the April following graduation.

Interest
Pre 2012 system - For those with loans taken out pre 2012 interest is added but only at the rate of inflation so whilst the amount of the loan may go up it is only ever worth the same as when it was taken out.

Post 2012 system - For loans after September 2012 Interest at the rate inflation plus 3% is added whilst studying.

Then following graduation if the graduate earns less than £21,000 interest is accrued at the rate of inflation until the earnings move above £21,000. At that time there is a sliding scale of interest in addition to the rate of inflation until a graduate is earning £41,000 or over. At which time interest is added at the rate of inflation plus 3%.

Talk to us

There are few, if any, sweeteners to this bitter pill but if you have a balance on a student loan and are earning over £41,000 then it may be possible to source a lower rate of interest.

Understanding Pensions Tax Relief

There are three different ways to give tax relief on pensions. The way that the tax relief is given is determined by the type of pension and the actual terms and conditions of the pension when it is set up.

With some pensions (usually employer) the contributions are taken from the gross pay so that what gets subjected to tax and national insurance is the pay AFTER deduction of the pension contributions and as such the employee has had the full tax relief (both basic and higher rate if appropriate).

Example - Salary per annum of £40,000, standard tax allowance for under 67 year olds, no other income (all figures rounded).

Monthly wage	£3,333.00
Tax	£ 490.00
NIC	£ 320.00
Take home	**£2,523.00**

Option A
In the same situation as above but with £100 paid into a pension taken from salary before tax and NI:

Monthly wage	£3,333.00	
Pension	£ 100.00	= **£100** actual pension contribution
Taxable salary	£3,233.00	
Tax	£ 470.00	
NIC	£ 308.00	
Take home	**£2,455.00**	

The **£100** pension contribution has dropped the take home pay by just **£68** giving the tax relief and national insurance relief immediately.

Option B

On other pensions (usually personal) the pay suffers tax and NIC first, it is only then that the pension contribution is deducted. In these cases the pension company reclaim tax relief from HMRC and the employee has to make a separate claim for any higher rate tax relief they are due through their Self-Assessment tax return - an example of this type of pension would be the Government backed NEST pension:-

Monthly wage	£3,333.00	
Tax	£ 490.00	
NIC	£ 320.00	
Take home	£2,523.00	
Pension contribution	£ 100.00 =	+HMRC tax relief = £125 gross pension contribution
Net Take home pay	**£2,423.00**	

In option A there is no need for the individual to make a separate claim for higher rate tax relief and the employee gets his tax relief straight away. The pension company don't have to collect the additional 20% top up from HMRC.

Salary Sacrifice

The final item to consider here is utilising a Salary Sacrifice scheme.

Using the same scenario as we have above, the only change from the description in Option A is that instead of the £100 pension being deducted from the top line of the salary, the salary is reduced under the contract of employment by the amount of the pension :-

Original salary	£3,333.00	
Salary Sacrifice	£ 100.00 =	**£100** actual pension contribution
Monthly wage	£3,233.00	
Tax	£ 470.00	
NIC	£ 308.00	
Take home	**£2,455.00**	

The **£100** pension contribution is now made by the employer and the reduced salary has dropped the take home pay by just **£68** giving tax relief and national insurance relief immediately.

The benefit for the employer is that the employer's NI is reduced by **£138** for every £1000 sacrificed, however the employer's tax position is effectively neutral. This is because, although the employer's business expense on salary drops by the amount sacrificed, the employer takes responsibility for paying the corresponding pension contribution, returning the business expense on employing the individual to the pre sacrifice amount.

VAT - Two Businesses One Person

It is the 'person', not the business, who is registered for VAT. A person can be either an individual or a legal person or entity, such as a partnership or a limited company, and each VAT registration covers all the business activities of the registered "person". If 2 people work together as a joint venture, the joint venture may have to register for VAT.

Summary of Key Points

- If you are setting up more than one business and intend not to register one or more for VAT, beware of the HMRC rules on artificial splitting.
- Maintain the separation of the different businesses in as many ways as possible.
- Avoid running the businesses in ways which make them appear to be the same business.

Related companies or limited liability partnerships can register as a single taxable person - a VAT group.

Joint ventures and VAT

If you and another person intend to work together on a business or project as a joint venture, HM Revenue and Customs (HMRC) may consider this as a partnership. This would be a new and separate person for VAT registration purposes. The joint venture may have to register for VAT if its turnover is above the relevant threshold - currently £82,000.

You may have two businesses which you feel are separate but are joined together for VAT purposes by the registered "person" rules, for example an owner of a hairdressing salon. The owner of the salon trades as a hairdresser and makes profits from hairdressing. In the salon the owner rents an area to a nail technician. This is two sources of income, hairdressing and chair rental, but for VAT purposes it would all count towards the threshold for VAT registration.

Talk to us

The essential question to be answered is "Are the businesses closely bound by financial, economic and organisational links?" We can help to define the position and make certain you do not fall foul of HMRC's tough rules on artificial splitting.

Landlords Face 100% Tax Rises

Landlords have always been restricted in the amount they could claim against their rental income for the interest they pay on their loans or mortgages. Prior to the summer 2015 budget landlords could claim an amount against profits for interest due on a loan up to the value of the property when it was first let. But from April 2017 the amount they can claim for their finance costs will be calculated as a basic rate tax reduction from their total tax liability.

This change will see some dramatic increases in tax liability for rental property owners, so to ease the burden the chancellor has decided to phase in the changes. From April 2017 individuals will be able to claim only 75% of the allowable interest from their property income with a further basic rate tax reduction from their income tax liability on the balancing 25%. The percentages change to a 50:50 split in 2018/19 and then to a 25:75 split in 2019/20 with the full impact being felt from April 2020 onwards.

What this means in practice is that tax will be applied to the rents received rather than after the interest is deducted.

Best shown by an example of a higher rate tax payer paying tax at 40%.

Currently	
The buy-to-let income is	£20,000 a year
Interest-only mortgage costs	£13,000 a year
Tax is due on the difference (profit)	£ 7,000 @40% = £2,800 for HMRC
Leaving £4,200 for the owner	
Fast forward to 2020	
Tax is due on the full rental income	£20,000 @40% = £8,000
There is a tax credit for interest paid	£13,000 @20% = £2,600 = £5,400 for HMRC
Leaving just £1,600 for the owner	

The tax bill has therefore gone up by an astonishing **93%.** But now imagine the interest rate rises slightly - say by half of one percent whilst the rental income remains the same, in the above scenario the owner would be making a **loss of £1,000**, whilst still paying HMRC **£4,750 in tax!**

The landlords worst affected are likely to be those who have bought recently and have large mortgages or where rents are comparatively low in relation to property prices, because rental income is likely to be lower relative to the landlord's mortgage costs.

Talk to us

It is vital now to keep all receipts for expenses incurred against your property rental income. Please speak to us if you are uncertain about what can and cannot be claimed.

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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