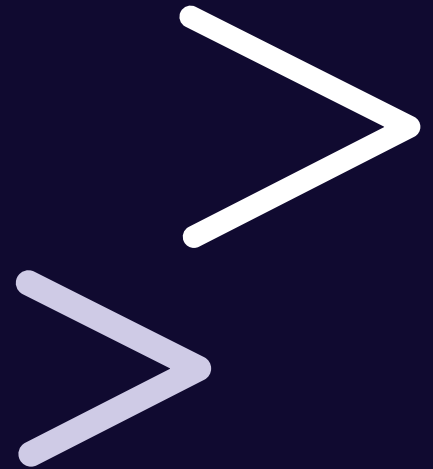


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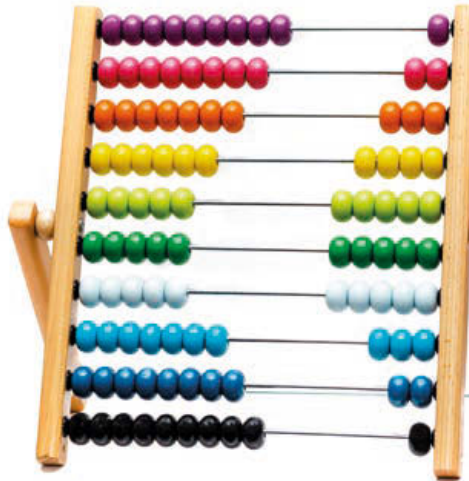


Taxes made easy

clear and concise tax guide 2020/21

Practical tax tips to guide you through the tax system and help you plan to minimise your liability.

Please use this guide to identify areas where you could take action, then contact us for advice and to discuss the most appropriate way forward.



Contents

A few essentials	2	Employer obligations Companies Income shifting Value Added Tax (VAT) Making Tax Digital (MTD)
Introduction		
The personal allowance		
Tax rates and allowances		
Self assessment (SA) timetable		
Family matters	5	Tax and your investments 17
Married couples		Pensions Tax free savings Other tax efficient investments
Children		
High Income Child Benefit Charge		
Tax-Free Childcare		
What about unmarried partners?		
A word of warning		
Working for others	8	Property matters 19
The tax code		Buy to let Main residence
Benefits		
Expense payments		
Running a business	11	Disposals and capital gains tax 21
Choosing a business structure		Entrepreneurs' Relief Investors' Relief
The tax regime		
Capital allowances		
Paying the tax		
		Preserving the inheritance 22
		Key features: So what's the problem? Mitigating the liability

A few essentials

Introduction

In the UK most income tax which flows into the Exchequer does so by deduction at source. The tax is taken from income before it is paid to the taxpayer and most of this happens by way of Pay as You Earn (PAYE). This collection system will no doubt be familiar to almost everyone who is in employment and also to those who receive pensions.

Many of us, including children, the retired and working people will have interest from savings accounts of one sort or another and many also have shares from which income arises in the form of dividends. The savings allowance and dividend allowance may cover this for most people so that this income is taxable at 0%.

As the circumstances described above cover the overwhelming majority of individuals, more than 80% of the population will have little or no regular contact with HM Revenue and Customs (HMRC), the organisation that administers and regulates all taxes in the UK.

Over 11 million taxpayers have something more than just a regular income taxed under PAYE or income covered by the savings and dividend

allowances. They might have income from their own business or receive rent from a property. Alternatively, it may be that their savings or dividend income is significant enough to result in tax being payable at the basic, higher or additional rates of tax. These taxpayers may be asked to complete a self assessment return each year and have direct contact with HMRC.

Practical Tip

If you are not asked to complete a tax return, it remains your responsibility to advise HMRC if there is a new source of untaxed income, a capital profit that could lead to a tax liability or you are subject to the high income child benefit charge. Please contact us for further advice if this affects you.

The personal allowance

In principle, all individuals are entitled to a basic personal allowance before any income tax whatsoever is paid. However, some individuals on high incomes may receive a reduced or even no personal allowance. This is explained further below.

The 2020/21 personal allowance is £12,500 and each individual may have taxable income up to £50,000 before they start to pay higher rate tax. See the devolved rates and bands for Scottish taxpayers set out later in this section.

Losing the personal allowance

Where an individual's total income exceeds £100,000 the personal allowance is reduced by £1 for every £2 of income in excess of that limit. This means that an individual with an income of £125,000 or more will not be entitled to any personal allowance.



Tax Tip

If your income is in the £100,000 - £125,000 range the restriction in your personal allowance is the equivalent of a tax cost of 60%. You may want to consider making or increasing certain payments which are tax deductible to minimise this tax cost.

Examples include pension contributions (which may be subject to restrictions) and charitable donations.

Tax rates and allowances

The income tax bands and rates for 2020/21 are determined by where you live in the UK and the type of income you have.

For most UK residents the following tax rates and bands apply:

Income tax band £	Rate %	Dividend rate %
0 - 37,500	20	7.5
37,501 - 150,000	40	32.5
Over 150,000	45	38.1

In addition, some taxpayers may be entitled to the starting rate for savings which taxes £5,000 of interest income at 0%. However, this rate is not available if non-savings income (broadly earnings, pensions, trading profits and property income) exceeds the starting rate limit.

Rates and bands for Scottish and Welsh taxpayers

For 2020/21 the tax rates and bands applicable to Scottish taxpayers on non-savings and non-dividend income are as follows:

Scottish income tax band £	Band name	Rate %
0 - 2,085	Starter	19
2,086 - 12,658	Basic	20
12,659 - 30,930	Intermediate	21
30,931 - 150,000	Higher	41
Over 150,000	Top	46

For 2020/21 the Welsh rate of income tax is set at 10% and this is added to the UK rates, which are each reduced by 10%. For 2020/21, the overall tax payable by Welsh taxpayers continues to be the same as English and Northern Irish taxpayers.

Scottish and Welsh taxpayers continue to pay tax on their savings and dividend income using the UK rates and bands.

Other allowances

Individuals may be entitled to savings allowance (SA), with savings income within the SA taxed at 0%. The amount of SA depends on an individual's marginal rate of tax. An individual taxed at the basic rate of tax has an SA of £1,000, whereas a higher rate taxpayer

is entitled to an SA of £500. Additional rate taxpayers receive no SA.

The dividend allowance (DA), available to all taxpayers regardless of their marginal tax rate, charges the first £2,000 of dividends to tax at 0%. Dividends received above this allowance are taxed at the rates shown in the table.

Dividends within the DA still count towards an individual's basic or higher rate band and so may affect the rate of tax payable on dividends above the £2,000 allowance.

Dividends are treated as the top slice of income. So the basic rate tax band is first allocated against other income.

Income tax is not the only means by which the government relieves us of our hard-earned cash. You may own assets such as a precious antique, a second home or shares. If such an asset is sold, the chances are that a profit will arise and this may give rise to a liability to capital gains tax (CGT).

Details of any capital gains may have to be included on the self assessment return.

Inheritance tax may be payable on the assets that you give to others in your lifetime or leave behind when you die. At one time very few individuals had to worry about this tax. House price increases have changed this and many more estates have now become liable, so you may need to consider some planning to minimise this tax.

Many of those in business have to understand the principles of Value Added Tax (VAT) because they will have to act as an unpaid collector of this tax. In addition, those who

run their business through a limited company need to know about corporation tax which taxes a company's profits. Employing others in your business brings further obligations with Real Time Information reporting for PAYE and auto enrolment pension contributions responsibilities. We consider these issues later in this guide.

Practical Tip

Remember to keep all tax related documents such as interest statements, dividend vouchers, pay certificate form P60 etc. Place everything in a folder through the year as it is received. Then you can simply hand this to us when we need to prepare your self assessment return.

HMRC is increasingly emphasising the importance of good records. Failure to maintain adequate records may lead to inaccurate tax returns, which could result in penalties.

Self assessment (SA) timetable

- Income tax and capital gains tax are both assessed for a tax year which runs from 6 April to the following 5 April.
- Shortly after 5 April - a notice to complete a return is issued by HMRC.
- 31 October following - non-electronic returns (where you have requested a paper return from HMRC or downloaded a blank return) need to be submitted to HMRC by this date.

- 31 January following - final date for submission of the return and all outstanding tax to be paid.
- There is an automatic penalty of £100 for late filing of the return.
- Further penalties may be due if the filing of the return is significantly delayed. These may run into hundreds of pounds.

Practical Tip

The full £100 penalty will always be due if your return is filed late even if there is no tax outstanding. It is therefore essential to submit the return on time either by 31 October (non-electronic) or otherwise by 31 January following the end of the tax year.

This guide is designed to provide you with an overview of all of these taxes from seven perspectives - that of the family; the employee; the person running their own business; the taxation of investments; property matters; disposals and CGT and, finally, knowing that nothing is certain except death and taxes, the potential liability on your estate at death.

Please use the guide to help you identify planning opportunities, pitfalls to avoid and areas where you may need to take action and then contact us for further advice.



Family matters

Married couples

Spouses are taxed as independent persons, each of whom is responsible for their own tax affairs. The phrase 'spouse' whenever used in this guide includes a registered civil partner.

For spouses, there is no aggregation of income, no sharing of the tax bands and except in limited circumstances detailed later in this guide, the personal allowance may not be transferred from one spouse to the other.

Minimising the tax bill

However tax can be minimised if spouses equalise, as far as possible, their income so that personal allowances, savings allowance (SA) and dividend allowance (DA) are fully utilised and higher/additional rates of tax are minimised.

Example

In 2020/21 Ian and Angela have savings income of £50,000, dividend income of £50,000 and no other income. If this is split equally between them, the total tax bill for the couple is £6,050. If only one spouse has an income of £100,000 and the other has nothing, the total tax bill leaps to £22,000 - an additional £15,950!

Tax Tip

If you are feeling charitable, remember that a donation to charity under the Gift Aid scheme benefits from tax relief. It makes sense for a higher rate/additional rate taxpayer spouse to make such donations so that they can benefit from the extra tax relief.

Alternatively, in some circumstances, donations can be carried back to attract tax relief in the previous tax year.

Tax breaks for spouses

Married couples and civil partners may be eligible for a Marriage Allowance (MA).

The MA enables spouses to transfer a fixed amount of their personal allowance to their spouse. The option to transfer is not available to unmarried couples.

The option to transfer is available to couples where neither pays tax at the higher or additional rate. If eligible, one partner will be able to transfer 10% of their personal allowance to their partner which means £1,250 for the 2020/21 tax year.

For those couples where one person does not use all of their personal allowance, the benefit will be up to £250 (20% of £1,250).

Jointly owned assets

Married couples will often own assets in some form of joint ownership. If they do not then it may be advantageous, for tax purposes, for transfers to be made to ensure joint ownership.

This can have benefits for income tax, CGT and even inheritance tax.

Tax Planning

If you and your spouse are both involved in running a business, income can be equalised if you are equal partners or equal shareholders. Alternatively, if only one of you is involved, the other could be employed in a small capacity, drawing a salary to use up their personal allowance.

Where assets are owned in joint names, any income is deemed to be shared equally between the spouses. If the actual ownership shares are unequal, income is still deemed to be split equally unless an election is made to split the income in the same proportion as the ownership of the asset.

This does not apply to shares in close companies (almost all small, private, family owned companies will be close companies) where income is always split in the same proportion as the shares are owned.

Example

A buy to let property is owned three quarters by Helen and one quarter by her husband Mark. If no election is made the net rental income on which tax is payable will be split 50:50.

If an election is made the income will be split 75:25. A choice can be made according to which is the most desirable when other income of the spouses is taken into account.

Capital gains tax

Independent taxation also applies to CGT. Each spouse is entitled to take advantage of the annual exemption of £12,300 before any CGT has to be paid.

This is advantageous where assets are held jointly and then sold as each spouse can use their annual exemption to save tax.

The transfer of assets between spouses is neutral for CGT. This is sometimes done shortly before assets are sold, to minimise tax. Advice should be sought before undertaking such transactions to ensure that all tax aspects have been considered. Please contact us for CGT advice.

Children

It is often assumed that children are not taxpayers. In fact HMRC will tax a child just as readily as anyone else if the child has sufficient income to make them liable.

Transferring income to children

Children have their own personal allowances and tax bands. Where their only income is, at best, a few pounds from a paper round or a Saturday job, there may be some scope for transferring income producing assets to the children to use up their personal allowance.

However, such assets should not be provided by a parent, otherwise the income remains taxable on the parent, unless it does not exceed £100 (gross) each tax year.

Tax Planning

There is nothing to stop you employing your children in the family business so as to take advantage of their personal allowance. There are age restrictions (with some exceptions the minimum age is generally 13 years old) and legal limitations as to the type and duration of the work. It is also essential that payment is only made for actual work carried out for the business and at a reasonable commercial rate.

Children and capital gains

Children also have their own annual exemption for CGT, so assets transferred to them which have a bias towards capital growth rather than income may prove to be more advantageous.

Child Trust Funds (CTFs)

The availability of new CTFs ceased from January 2011, as did government contributions to the accounts. Existing CTFs however continue to benefit from tax free investment growth. No withdrawals are possible until the child reaches age 18. However, the child's

friends and family are able to contribute up to the annual limit of £9,000. It is possible to transfer the investment to a Junior Individual Savings Account (ISA).

CTFs will start to mature from September 2020 when the first eligible children begin to turn 18. On maturity funds can be either withdrawn or left in the tax advantaged CTF account pending instructions from the account holder. Alternatively the savings can be transferred to an ISA and the amount transferred will be disregarded for the annual ISA subscription limit.

Junior ISA

A Junior ISA is available for UK resident children under the age of 18 who do not have a CTF account. Junior ISAs are tax advantaged and have many features in common with existing ISAs.

They are available as cash or stocks and shares based products but a child can only have one cash Junior ISA and one stocks and shares Junior ISA. The annual investment is limited to £9,000.

Tax Planning

There are some other limited ways income can be transferred to children tax efficiently such as:

- National Savings Children's Bonds which are tax free.
- Friendly Societies offer 10 year minimum, tax exempt savings plans for children for up to £25 per month.

High Income Child Benefit Charge

A charge arises on a taxpayer who has adjusted net income over £50,000 in a tax year where either they or their partner are in receipt of Child Benefit for the year. Where both partners have adjusted net income in excess of £50,000 the charge applies to the partner with the higher income.

The income tax charge applies at a rate of 1% of the full Child Benefit award for each £100 of income between £50,000 and £60,000. The charge on taxpayers with income above £60,000 will be equal to the amount of Child Benefit paid.

Child Benefit claimants are able to elect not to receive Child Benefit if they or their partner do not wish to pay the charge.

Equalising income can help to reduce the charge for some families.

Example

Phil and Jane have two children and receive £1,820 Child Benefit. Jane has little income. Phil expects his adjusted net income to be £55,000. On this basis the tax charge will be £910. This is calculated as $£1,820 \times 50\%$ ($£55,000 - £50,000 = £5,000 / £100 \times 1\%$).

If Phil can reduce his income by £5,000 to £50,000 no charge would arise. This could be achieved by transferring investments to Jane or by making additional pension or Gift Aid payments.



Tax-Free Childcare

The scheme is available to families where all parents are working (on an employed or self-employed basis) 16 hours a week and meet a minimum income level (generally £139 a week) with each earning less than £100,000 a year. Parents who are receiving support through Tax Credits or Universal Credit are not eligible.

Parents need to register with the government and open an online account. The government 'top up' payments into this account at a rate of 20p for every 80p that families pay in. The scheme is generally limited to £10,000 per child per year. The government's contribution is therefore a maximum of £2,000 per

child.

Employer Supported Childcare (see the Working for Others section) closed to new entrants on 4 October 2018. Parents who qualify for both schemes are able to choose which scheme they wish to use but families cannot benefit from both schemes at the same time. To find out about all childcare options visit www.childcarechoices.gov.uk

What about unmarried partners?

It still pays to equalise income as much as possible, as income tax will be minimised.

However, transfers of assets may be liable to CGT and, if substantial, could also lead to an inheritance tax liability. It is vital for unmarried couples to each make a Will if they wish to benefit from each other's estate at death.

Remember all the special rules for married couples, both those dealt with in this section and those covered in other sections of this guide, apply equally to same-sex couples who have entered into a registered civil partnership or marriage.

A word of warning

Transferring assets or interests in a business between husband and wife may attract the interest of HMRC especially where it is obvious that it has been done primarily for tax saving purposes. Transfer of ownership of an asset must be real and complete, with no right of return and no right to the income on the asset given up.

If a non-working spouse is given shares in an otherwise one-person, private company, HMRC may, in some circumstances, seek to tax the working spouse on all of the dividends under what is known as the 'settlements legislation'. You may want to consider obtaining advice from us before entering into this type of arrangement.

Checklist for Couples

- ✓ Try to equalise your income.
- ✓ Consider placing assets in joint names.
- ✓ If you have children consider making use of their personal allowances.

Working for others

Few avoid working for others at some time in their life and most will have encountered the PAYE system operated by employers to collect the income tax and national insurance contributions (NICs) due on wages and salaries.

The tax code

Ensuring the right amount of tax is taken relies on a PAYE code, issued by HMRC and based on information given in a previous self assessment return or supplied by the employer. The employee, not the employer, is responsible for the accuracy of the code.

Code numbers try to reflect both an individual's tax allowances and reliefs and also any tax they may owe on employment benefits and in some cases other types of income. For many employees things are simple. They will have a set salary or wage and only a basic personal allowance. Their code number will be 1250L and the right amount of tax should be paid under PAYE. However, for those who are provided with employment benefits the code number is generally adjusted to collect the tax due so that there are no nasty underpayment surprises. HMRC may also try to collect tax on untaxed income, tax on dividends and tax owing for an earlier year.

For Scottish taxpayers a letter 'S' is included in the tax code and denotes that the Scottish

income tax rates apply to an employee's pay, rather than the rates and bands which apply across the rest of the United Kingdom (see the 'A few essentials' section of this guide for details of rates and bands).

For Welsh taxpayers a letter 'C' is included in the tax code. For 2020/21 Welsh taxpayers pay the same overall rates of income tax as taxpayers in England and Northern Ireland.

With so many complications and some guesswork involved, getting the code exactly right can be difficult and the right amount of tax will not always be deducted.

Tax Tip

If you are unsure about your code and are anxious not to end the tax year under or overpaid, then you should have it checked. HMRC may update an individual's tax code during the tax year to reflect changes to benefits and to collect tax underpayments. Please talk to us about getting your tax code checked.

Benefits

The range of benefits available will vary significantly depending on the type of employment. Some attract no tax but even taxable benefits can be efficient as the benefit

obtained by the individual can often outweigh the tax cost arising. In addition, for the individual (but not the employer) benefits generally do not attract NICs.

Valuation

Rules were introduced from April 2017 which may affect the value of a benefit. Where a benefit is taken rather than an alternative cash option, the taxable value of the benefit is the higher of the cash foregone or the taxable value under the normal benefits rules. Transitional provisions apply for arrangements entered into before 6 April 2017. Contact us for the correct valuation of benefits.

Company cars

Employer provided cars, commonly known as company cars, remain a popular benefit and for some a real status symbol, despite continued increases in the tax charge they give rise to.

The charge on cars is generally calculated by multiplying the list price of the car by a percentage which depends on the CO₂ emissions (recorded on the Vehicle Registration Document) of the car. You then pay tax at 20%, 40% or 45% on this charge depending on your overall tax position. The tax rates applicable to Scottish taxpayers range from 19% to 46%.



The table on the next page shows the percentages for 2020/21. The table is divided into two columns for cars registered up to 5 April 2020 and those registered after that date. The table reflects the differences between the new Worldwide harmonised Light vehicle Test Procedure (WLTP) and the New European Driving Cycle (NEDC) test it is replacing.

For most company cars registered after 5 April 2020 car benefit rates will be reduced by two percentage points for 2020/21 from the rates previously announced for that year. Additionally, to accelerate the shift to zero-emission cars, all zero-emission models, regardless of when they were registered, will be subject to a 0% rate. Thus drivers of these cars will pay no company car tax in 2020/21. Both these rates will rise by a single percentage point in each of the following two tax years.

In addition, the government has reduced the percentages which apply to lower emissions cars and introduce new performance-related bands for hybrid vehicles with emissions up to 50 g/km depending on how far the hybrid vehicle can travel under electric power.

Example

David has a company car, a Hyundai Ioniq, which had a list price of £28,395 when it was provided new on 6 April 2019. The CO₂ emissions are 26 g/km and its electric range is 39 miles.

David's BiK for 2020/21 is: £28,395 x 12% = £3,407. David's benefit has reduced from £4,543 in 2019/20 when it was £28,395 x 16%.

2020/21	Cars registered after 5.4.20	Cars registered before 6.4.20
CO ₂ emissions (g/km)	% of list price taxed	% of list price taxed
1 – 50 (split by zero-emission miles)	0	0
>130	0	2
70-129	3	5
40-69	6	8
30-39	10	12
<30	12	14
51 – 54	13	15
55 – 59	14	16
60 – 64	15	17
65 - 69	16	18
70 - 74	17	19
75 - 79	18	20

For every additional 5g thereafter add 1% until the maximum percentage of 37% is reached.

For fully diesel cars generally add a 4% supplement (unless the car is registered on or after 1 September 2017 and meets the Euro 6d emissions standard) but the maximum is still 37%. For emissions over 75g/km if the CO₂ figure does not end in a 5 or a 0 round down to the nearest 5 or 0.

Fuel for private use

A separate charge applies where private fuel is provided by the employer for a company car. The charge is calculated by applying the same percentage figure used to calculate the company car benefit to a fixed figure which for 2020/21 is set at £24,500. No fuel benefit applies to an electric car.

Tax Planning

The fuel benefit charge can be expensive. It may be cheaper for the employee to pay for all the fuel and to reclaim from the employer the cost of business miles driven in a company car based on a specific log of business journeys undertaken.

HMRC publish advisory fuel rates for company cars which are updated on a quarterly basis. See [gov.uk/government/publications/advisory-fuel-rates](https://www.gov.uk/government/publications/advisory-fuel-rates) for the latest position or contact us.

Medical insurance

The employee is taxed on the amount of the premium paid by the employer.

Home and mobile phones

There is no benefit on the provision of a company mobile phone even where it is used privately. However, this is limited to one phone per employee.

Where home telephone bills are paid by the employer, the amount paid will be taxable. The employee may make a tax deduction claim for the cost of business calls only but not the line rental.

Cheap or interest free loans

If loans made by the employer to an employee exceed £10,000 at any point in a tax year, tax is chargeable on the difference between the interest paid and the interest due at an official rate - currently set at 2.25% per annum. An exception applies for certain qualifying loans - please contact us for information.

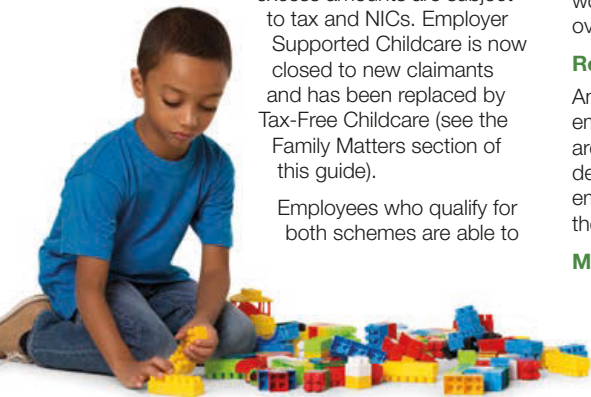
Tax Tip

The £10,000 limit on tax free loans is an attractive perk for many employees.

Childcare costs

Childcare costs paid for by an employer may be exempt from both income tax and NICs. This applies to a place in an employer operated nursery and to Employer Supported Childcare as long as the claimant entered the Scheme before 4 October 2018. In the latter case, the exemption is limited and excess amounts are subject to tax and NICs. Employer Supported Childcare is now closed to new claimants and has been replaced by Tax-Free Childcare (see the Family Matters section of this guide).

Employees who qualify for both schemes are able to



choose which scheme they wish to use but families cannot benefit from both schemes at the same time.

Pension contributions

Contributions by an employer to a registered pension scheme are generally tax and NICs free for most employees. This may be far better than any other perk.

Tax Tip

You may want to sacrifice some of your 'normal' salary to do this. Please talk to us to make sure your salary sacrifice scheme is effective.

Expense payments

An employee can claim tax relief for expenses which are incurred wholly, exclusively and necessarily for business purposes. The main types of expense are travelling to places for work (but not the normal place of work) and overnight accommodation.

Reimbursed expenses

An employer would normally reimburse an employee for business expenses. Employers are no longer required to report reimbursed tax deductible business expenses and therefore employees do not need to claim tax relief on these expenses.

Mileage claims

Many employers pay a standard rate of mileage to all employees who use their own cars for business journeys. HMRC set statutory rates for business mileage

which are 45p for the first 10,000 miles in a tax year and 25p thereafter.

If the employee is paid for business miles at less than the statutory rates, tax relief is available on the difference. If, however, the employee is paid at more than these rates then the excess is taxable.

If you are paid less than the statutory rates to use your own car for business purposes remember to claim a deduction on your return or write to HMRC to make your claim.

Example

In 2020/21 Michael travels 14,100 business miles in his own car and is paid 32p per mile by his employer.

Michael can claim tax relief on an additional amount of £1,013 $((10,000 \times 45p) + (4,100 \times 25p)) - (14,100 \times 32p)$.

Vans

Where employees are provided with a van and the only private use of this is to travel to and from work (including any incidental private use), then no taxable benefit should arise. If there is private use beyond this, there is a benefit of £3,490 for 2020/21 and an additional £666 if fuel is provided for private as well as business journeys. In order to avoid this charge, it is advisable to have a formal written policy, detailed mileage logs and make use of vehicle tracker records. These will support the limited private use of the van and may avoid problems with HMRC in the future.

Running a business

Starting up a business of your own is a big step and not one to take lightly. The taxation of your business is only one of many commercial and legal aspects of starting a business that you will need to consider.

Preparation is the key and a proper business plan is one of the first things you should do. However, tax matters are our main concern here.

Choosing a business structure

The alternative business structures are:

Sole trader

This is the simplest form of business structure since it can be established without legal formality.

The business of a sole trader is not distinguished from the proprietor's personal affairs. If the business incurs debts which are unpaid, the creditors can seek repayment from the sole trader personally.

Partnership

A partnership is similar in nature to a sole trader but involves two or more people working together.

A written agreement is essential so that all partners are aware of the terms of the

partnership. Again, the business and personal affairs of the partners are not legally separate.

Sole traders and partnerships are often referred to as unincorporated businesses and the individual owners as self-employed.

Limited company

A company is a legal entity in its own right, separate from the personal affairs of the owners and the directors.

A company provides protection from liability, which means that the creditors of the company cannot make a claim against the owners or the directors except in limited circumstances. Often this advantage is somewhat eroded because a bank, for example, may seek personal guarantees from the directors.

These potential advantages carry the downside of greater legal requirements and regulations that must be complied with.

Limited Liability Partnerships (LLPs)

LLPs are a halfway house between partnerships and companies.

They are taxed in the same way as a partnership but are legally a corporate body. This again gives some protection to the owners from the partnership's creditors.

In this guide we consider the differing tax treatments of the alternatives but you should

choose which structure is right for you based on more than just the tax issues alone.

The tax regime

Unincorporated businesses

A new business should register with HMRC on commencing to trade. Income tax is paid on the profits of the business. The amount that the proprietor, or a partner in a partnership, draws out of the business (referred to as 'drawings') is irrelevant.

Profits are taxed on a current year basis as shown by the example, although a new business will be subject to special rules, which we will be pleased to explain to you.

Example

If the accounting period (or 'year') end is 31 March then, in the tax year 2020/21, the profits for the year ended 31 March 2021 will be taxed.

If the year end was 31 August then, in the tax year 2020/21, the profits for the year ended 31 August 2020 will be taxed.

Tax Tip

The choice of accounting date on a business start up can affect:

- how profits are taxed
- when tax is payable
- when losses are relieved.

So do contact us to discuss the options available for your circumstances.

Working out profits

Profits are calculated using accepted accounting practices and crucially this means that profit is not necessarily simply receipts less payments. Instead it is income earned less expenses incurred. However, see details of the optional cash basis for smaller unincorporated businesses.

Not all of the expenses that a business incurs are allowed to be deducted from income for tax purposes but most are. It is important that you keep proper and comprehensive business records so that relief may be claimed.

Tax Tip

Try to incur expenditure just before rather than just after the year end, as this will accelerate the tax relief.

Examples of the type of expenditure to consider bringing forward include building repairs and redecorating, advertising, marketing campaigns and expenditure on plant and machinery.

Trading and property income allowances

Trading and property income allowances of £1,000 per annum are available. Individuals with trading or property income below £1,000 do not need to declare or pay tax on that income. Those with income above the allowance are able to calculate their taxable profit either by deducting their expenses in the normal way or by simply deducting the relevant allowance.

Cash basis for smaller unincorporated businesses

An optional basis for calculating taxable profits is available to small unincorporated businesses. If an owner of a business decides to use the cash basis, the business profits would be taxed on cash receipts less cash payments of allowable expenses subject to a number of tax adjustments.

The optional scheme requires an election by the business owner and is only available where the business receipts are less than £150,000. Businesses can stay in the scheme up to a total business turnover of £300,000 per year.

Further details about the scheme:

- Cash receipts include all amounts received in connection with the business including those from the disposal of plant and machinery. The good news is that if a



customer has not paid what is owed by the year end, the amount due is not taxable until next year.

- Allowable payments include paid expenses but these still need to meet the existing tax rule of being wholly and exclusively incurred for the purposes of the trade.
- Payments include most purchases of plant and machinery, when paid, rather than claiming capital allowances. The bad news is that if a supplier is not paid by the year end, the amount is not relievable until next year.
- Interest payments are only allowed up to a limit of £500.
- Business losses may be carried forward to set against the profits of future years but not carried back or set off 'sideways' against other sources of income.

Do get in touch if you would like us to consider if this optional scheme is appropriate for you and your business.

Capital allowances

When assets are purchased for the business, such as machinery, office equipment or motor vehicles, capital allowances are available. As with expenses, these are deducted from income to calculate taxable profit.

Plant and machinery - Annual Investment Allowance (AIA)

The AIA from 1 January 2019 gives a 100% write off on most types of plant and machinery costs, but not cars, of up to £1,000,000 per annum (reducing to £200,000



from 1 January 2021). Special rules apply to accounting periods which straddle these dates. Any costs incurred in excess of the AIA will attract an annual ongoing allowance of 6% or 18% depending upon the type of asset.

Other allowances include a 100% allowance on certain energy efficient plant and machinery within designated areas in Enterprise Zones and zero-emission cars, goods vehicles and equipment for gas refueling stations.

Motor cars

The tax allowance on a car purchase depends on CO₂ emissions. Currently purchases of new unused cars with emissions of up to 50g/km attract a 100% first year allowance, while cars with emissions of up to 110g/km attract an 18% allowance and those in excess of 110g/km are only eligible for an 6% allowance.

Structures and Buildings Allowance (SBA)

The SBA gives an annual rate of capital allowances to qualifying investments incurred on or after 29 October 2018 to construct new, or renovate old, non-residential structures and buildings. The initial rate of 2% was increased to 3% from 1 April 2020 for corporation tax and 6 April 2020 for income tax.



Paying the tax

The self-employed may have to pay tax and NICs three times a year, namely:

- 31 January in the tax year
- 31 July following the tax year
- 31 January following the tax year.

In certain circumstances, the first two payments can be waived. Because of the COVID-19 outbreak, the second payment on account due for the 2019/20 tax year on 31 July 2020 can be deferred until January 2021.

Employer obligations

As an employer you will have many responsibilities. These will include employment law requirements which are not covered in this guide and HMRC requirements to report pay and benefits. Two other requirements place a further burden on employers.

Real Time Information

Real Time Information (RTI) reporting is mandatory for broadly all employers.

Under RTI, employers or their agents are required to make regular payroll submissions for each pay period during the year. The submissions detail payments made to and deductions made from employees. These submissions must generally be made on or before the date the amounts are paid to the employees.

The RTI submission details payments made which include salary, overtime and statutory payments such as statutory maternity pay. It

also details the income tax, national insurance contributions (NICs) due together with other deductions such as student loan repayments.

The PAYE and NICs on salaries is payable monthly (or quarterly where the amount due is less than £1,500 per month).

Penalties apply to employers who fail to make returns on time. These penalties range from £100 to £400 per month depending on the size of the employer. Interest and penalties also apply for failing to pay on time.

The employer must also report details of expenses and benefits provided to employees. More information on the valuation of benefits is contained in the Working for Others section of this guide.

Pensions Auto Enrolment (AE)

AE obliges employers to automatically enrol 'workers' into a work based pension scheme. Duties include:

- assessing the types of workers in the business
- providing a qualifying automatic enrolment pension scheme
- automatically enrolling all 'eligible jobholders' into the scheme and
- paying employer contributions.

All employers generally need to contribute at least 3% of the 'qualifying pensionable earnings' for eligible jobholders.

If the employer only pays the employer's minimum contribution, employees' contributions are generally 5% to meet the overall minimum 8% contribution rate. There

are different ways of calculating minimum contributions and the employee contributions may be paid net of basic rate tax depending on the type of pension scheme.

Practical Tip

All employers have to comply with Auto Enrolment from when they first take on an employee. We can help you to deal with Auto Enrolment.

Companies

Unlike sole traders and partnerships who pay tax on profits only (and drawings are ignored), companies have two layers of tax. The first is tax payable by directors and shareholders on money they take out of the company and the second is corporation tax which is due on the company's profits

Practical Tip

If you operate as a limited company, there is a legal separation between you as the owner and the company itself. This means you cannot use the company bank account as if it were your own! This requires a certain amount of discipline without which all kinds of legal and tax related difficulties can occur.

Corporation Tax

Companies currently pay corporation tax at 19%.

Tax on 'drawings'

Directors of a company will normally be paid a salary and this is taxed under PAYE as for all employees. The cost of this, including the employer's NICs, is generally an allowable expense of the company. Shareholders of the company in contrast may be rewarded by the payment of dividends on their shares.

Tax Tip

In most small companies the directors and shareholders are one and the same and so they can choose the most tax efficient way to pay themselves. Using dividends can result in savings in NICs. This requires planning and needs to take account of the Dividend Allowance, which taxes dividends within the allowance at 0%, and dividend rates of tax.

The Dividend Allowance is currently £2,000 so careful planning is required. Please talk to us to decide what is appropriate for you.

Warning - close company loans to participators

A close company (which generally includes owner managed companies) is taxed in certain circumstances when it has made a loan or advance to individuals or their family members who have an interest or shares in the company (known as participators). The tax charge is currently 32.5% of the loan if it is outstanding nine months after the end of the accounting period. The tax charge is repaid to the company nine months after the end of the accounting period in which the loan is repaid.

Further rules prevent the avoidance of the charge by repaying the loan before the nine month date and then effectively withdrawing the same money shortly afterwards.

A '30 day rule' applies if at least £5,000 is repaid to the company and within 30 days new loans or advances of at least £5,000 are made to the shareholder. The old loan is effectively treated as if it has not been repaid. A further rule stops the tax charge being avoided by waiting 31 days before the company advances further funds to the shareholder. This is a complex area so please do get in touch if this is an issue for you and your company.

Planning Tip

Ensure that sufficient salary and dividends are drawn from the business to prevent these charges arising unnecessarily on an overdrawn director's current account. We can also ensure that overdrawn accounts are cleared properly. Please contact us if you would like to discuss the right options for you and your business.



Tax on profits

The profits of a limited company are calculated in a similar way as for unincorporated businesses and the same rules with regard to expenses and capital allowances generally apply. Remember though that the salaries paid to directors, but not the dividends paid to shareholders, are deductible from the profits before they are taxed.

Tax Planning

Companies are a popular business structure as they generally result in less tax being paid overall.

We would be happy to discuss the implications of incorporation with you before you decide whether or not to incorporate your business.

Payment of tax

Corporation tax is usually payable nine months and one day after the year end, so the choice of accounting date has no tax consequence.

Practical Tip

HMRC issues toolkits on various tax topics to help taxpayers and their agents comply with tax law. One of the main areas of non compliance identified by HMRC is poor record keeping and this applies to all types of business. If you would like guidance on what records to keep please get in touch.

Tax relief for expenditure on Research and Development (R&D)

Companies with expenditure in qualifying R&D activities can receive tax relief - the rates of the relief depend on the type of company:

- for small and medium-sized companies (SMEs) paying corporation tax at 19%, the effective rate of tax relief is 43.7% (that is a tax deduction of 230% on the expenditure). For SMEs not yet in profit, the relief can be converted into a tax credit payment, effectively worth 33.35% of the expenditure
- an 'above the line' credit exists for companies not qualifying under the SME scheme. This is known as the R&D Expenditure Credit (RDEC) scheme and allows a claim to a taxable credit of 13% (12% prior to 1 April 2020). The credit is fully payable, net of tax, to companies with no corporation tax liability.

This is a complex area. Please get in touch if you would like to know more.

Value Added Tax (VAT)

VAT is a tax ultimately paid by the final consumer and businesses act as the collectors of the tax. There are heavy fines for failing to operate the system properly.

What does VAT apply to?

VAT is chargeable on the supply of goods and services in the UK when made by a business that is required to register for VAT.

A registered business must charge VAT on its sales which is known as output VAT. There

are currently three rates of VAT which can be payable on what are known as taxable supplies. These are the standard rate of 20%, the reduced rate of 5% and the zero rate.

The zero rate applies where the supply is deemed to be subject to VAT but the output VAT is charged at 0%, meaning that no VAT is actually payable.

However, a business also pays VAT on the goods and services it buys. This is known as input tax.

If the output tax exceeds the input tax, then a payment of the difference has to be made to HMRC. If input tax exceeds output tax a repayment of VAT will be made. This calculation is generally done on a quarterly basis. However where repayments occur regularly it is possible to opt for monthly VAT returns. Regular repayments would perhaps apply where a business generally makes zero rated supplies.

Supplies

Certain supplies of goods and services are not subject to VAT at all and are known as exempt supplies. A business that makes only exempt supplies cannot register for VAT and will be unable to reclaim any input tax.

Tax Tip

When you first register for VAT you can reclaim input tax on goods purchased up to four years prior to registration provided they are still held when registration takes place. VAT on services supplied in the six months prior to registration may also be reclaimed.

As there are three rates which can be applicable to taxable supplies, standard, reduced or zero rated, it is important to identify the type of supplies correctly and apply the correct percentage of VAT.

Some input VAT is not reclaimable by a VAT registered business. Two common examples are VAT incurred on entertaining UK business customers and VAT on the purchase of a car.

Do I need to register?

A business must register if its taxable supplies exceed an annual figure, currently £85,000. If taxable supplies are less than this a business may still register voluntarily. So, for example, if the business makes only zero rated sales, it can still register and reclaim the input tax suffered.

VAT can affect competition. A plumber, for example, who sells only to the general public, will be at a disadvantage if he has to register for VAT.

He may have to charge up to 20% more than a plumber who is not registered to earn the same profit.

On the other hand, if the same plumber only works for other VAT registered businesses, such as building companies, then it will not matter whether he is registered because the customer will be able to recover the VAT that is charged.

Indeed, in general, a business that always sells to other VAT registered businesses will normally register, even if below the annual limit, because then it can reclaim VAT on purchases and expenses

This will improve profit and can be especially relevant for new businesses because there are often high initial set up costs that carry VAT. On the other hand, registration comes at the cost of having to meet onerous record keeping requirements, a need to submit online VAT returns and pay online and on time.

Making Tax Digital (MTD)

MTD for VAT is part of a government strategy which will ultimately require taxpayers to move to a fully digital tax system.

Under the MTD for VAT rules, businesses with a turnover above the VAT threshold must keep digital records for VAT purposes and provide their VAT return information to HMRC using MTD functional compatible software.

Businesses below the VAT threshold which have voluntarily registered for VAT can opt to join the scheme.

There are some exemptions from MTD for VAT. However, the exemption categories are tightly-drawn and are unlikely to be applicable to most VAT registered businesses.

We can help you to meet your MTD for VAT obligations.



Tax and your investments

Setting aside income in the form of savings is important for us all, to provide for the unexpected or to build up a nest egg that we can enjoy in retirement.

Pensions

Pensions are one of the most tax efficient forms of saving. Most higher rate taxpayers can contribute £100 to a registered pension fund at a cost of only £60 and investment income and capital gains will accrue within the scheme largely tax free. Contributions are paid net of basic rate tax and the pension provider will then recover that basic rate tax from HMRC. Higher and additional rate relief, if appropriate, can be claimed from HMRC.

An individual is entitled to tax relief on personal contributions in any given tax year up to the higher of 100% of earned income or £3,600 (gross).

For employees, if the contributions are deducted from salary payments, tax relief is given in the same way as for an individual paying personal pension contributions. In some cases, the pension contribution is paid gross to the pension provider and the contribution is deducted from salary before an employee's tax is calculated. Tax relief is therefore given automatically.

An employer may make contributions to a scheme and a deduction from profits may be available to the employer.

There are controls which serve to limit the availability of tax relief on high levels of contribution. These are complex but, put simply, they may give rise to a tax charge if annual contributions exceed £40,000 or if the value of the fund when benefits are taken is greater than a lifetime allowance which, for 2020/21, is £1,073,100. Generally where a taxpayer has adjusted income in excess of £240,000 the annual contribution possible will be restricted from £40,000 by £1 for every £2 for the excess income. The minimum annual allowance available after this restriction is £4,000.

Pensions freedom

Taxpayers have choice and flexibility when it comes to accessing their personal pension fund. Options include taking a tax free lump sum of 25% of fund value and purchasing an annuity with the remaining fund or opting for a more flexible drawdown.

The flexible drawdown rules allow for total freedom to access a pension fund from the age of 55. Access to the fund may be achieved in one of two ways:

- allocation of a pension fund (or part of a pension fund) into a 'flexi-access drawdown

account' from which any amount can be taken over whatever period the person decides

- taking a single or series of lump sums from a pension fund (known as an 'uncrystallised funds pension lump sum').

When an allocation of funds into a flexi-access account is made the member typically will take the opportunity of taking a tax free lump sum from the fund.

The person will then decide how much or how little to take from the flexi-access account. Any amounts that are taken will count as taxable income in the year of receipt.

Access to some or all of a pension fund without first allocating to a flexi-access account can be achieved by taking an uncrystallised funds pension lump sum.

The tax effect will be:

- 25% is tax free
- the remainder is taxable as income.

Getting the right advice at the point of retirement is therefore important.

Money Purchase Annual Allowance

The government is alive to the possibility of people taking advantage of the flexibilities by 'recycling' their earned income into pensions

and then immediately taking out amounts from their pension funds. The MPAA sets the maximum amount of tax-efficient contributions an individual can make at £4,000 per annum in certain scenarios.

Tax free savings

Tip

Don't forget to use the dividend and savings allowances. These allowances tax £2,000 of dividends and up to £1,000 of savings income at 0%. See 'other allowances' in the 'A few essentials' section.

Individual Savings Accounts (ISAs)

ISAs are free of income tax and CGT. There are maximum investment limits which apply for each tax year but, over several years, large investments can be built up. The overall annual ISA savings limit is £20,000. Investors can choose to invest in a cash ISA, stocks and shares ISA or an Innovative Finance ISA as long as they do not exceed the investment limit.

Lifetime ISA

The Lifetime ISA for adults is available to those under the age of 40. Individuals are able to contribute up to £4,000 per year and receive a 25% bonus from the government. If £4,000 is invested, the investment limit for the other types of ISAs falls to £16,000. Funds, including the government bonus, can be used to buy a first home up to £450,000 at any time from 12 months after the first subscription or can be withdrawn from age 60 completely tax-free.

Other tax efficient investments

The following investments work in varying ways. You should consider your needs in detail before entering into any commitments.

National Savings and Investment (NS&I) Premium bonds

Premium bonds are tax free and you could win £1 million!

However, the annual rate of return is not predictable. The current Premium bonds investment limit is £50,000. The more you invest the more frequently you are likely to win, the smaller prizes at least. However, there is no guarantee of a steady rate of return.

Single premium insurance bonds

The growth on insurance bonds is taxed at 20% and paid directly out of the bond. For a higher rate taxpayer bonds provide a means of deferring income into a subsequent period when it may be taxed at a lower rate. Withdrawals of up to 5% of the original investment can be made each year without incurring an immediate tax charge.

Complex tax reliefs can be available on withdrawal or on maturity of the bonds. Please consider taking advice on the implications prior to making withdrawals in excess of the annual 5% limit and on maturity.



Venture Capital Trusts (VCT)

These bodies mainly invest in the shares of unquoted trading companies. VCT are however quoted investments. An investor in the shares of a VCT will be exempt from tax on dividends and on any capital gain arising from disposal of the shares in the VCT. Income tax relief currently at 30% is available on subscriptions for VCT shares, up to £200,000 per tax year, so long as the shares are held for at least five years.

The Enterprise Investment Scheme (EIS)

Income tax relief at 30% is available on new equity investment (in qualifying unquoted trading companies) of up to £1 million. A higher limit of £2 million may apply to investments in 'knowledge intensive companies'. A CGT exemption may be given on sales of EIS shares held for at least three years. If the gain on the sale of any chargeable asset (eg quoted shares, second homes, etc) is reinvested in EIS shares, the gain on the disposal can be deferred.

Seed Enterprise Investment Scheme (SEIS)

The tax breaks for SEIS investors are:

- income tax relief at 50% in respect of qualifying SEIS shares up to an annual maximum investment (in all SEIS companies) of £100,000
- a CGT exemption where SEIS shares are sold more than three years after they are issued (as for EIS)
- a further CGT exemption of 50% where an individual makes a capital gain and reinvests the gain in qualifying SEIS shares.

Property matters

Direct investment in residential property has always been a popular form of investment.

Buy to let

The UK property market, whilst cyclical, has proved over the long-term to be a successful investment. This has resulted in a massive expansion in the buy to let sector.

Traditionally, buy to let involves investing in property with the expectation of capital growth with the rental income from tenants covering the mortgage costs and any outgoings. However the gross return from buy to let properties, the rent less expenses, can change. Investors also need to take a view on the likelihood of capital appreciation exceeding inflation. Investors should take a long-term view and choose properties with care.

Practical Tip

When choosing between investments always consider the differing levels of risk and your requirements for income and capital in both the short and long term. An investment strategy based purely on saving tax is not appropriate.

Which property?

Investing in a buy to let property is not the same as buying your own home. You may wish to get an agent to advise you of the local market for rented property. An agent will also be able to advise you of the standard of decoration and furnishings which are expected to get a quick let.

Letting property can be very time consuming and inconvenient. Tenants will expect a quick solution if the central heating breaks down over the bank holiday weekend! Do not cut corners - a correctly drawn up tenancy agreement will ensure the legal position is clear.

Devolution of Property Taxes

Stamp Duty Land Tax (SDLT) applies in England and Northern Ireland, Land and Buildings Transaction Tax (LBTT) in Scotland and Land Transaction Tax (LTT) in Wales.

Higher rates of SDLT, LBTT and LTT apply on purchases of additional residential properties.

The rates are 3% above the SDLT and LTT rates and 4% above the LBTT rates. The higher

rates potentially apply if, at the end of the purchase transaction, the individual owns two or more residential properties.

There are some exemptions from the rules. One of these covers the replacement of a main residence within certain time limits. Please contact us for further advice on this area.

Tax on rental income

Income tax will be payable on the rents received after deducting allowable expenses. Allowable expenses include mortgage interest, which is restricted in the case of residential property, repairs, agent's letting fees and the cost of replacing furnishings.

Restriction of relief for finance costs on residential lettings

The amount of income tax relief landlords can get on residential property finance costs is being restricted to the basic rate of income tax. Relief is given by way of a basic rate reduction rather than the costs being deductible in full from the rental income. This restriction to a basic rate reduction has been phased in over four years from April 2017. This reduction may be subject to further restrictions



where property or other non-savings income is insufficient.

Main residence

An individual's or married couple's only or main residence is generally exempt from Capital Gains Tax (CGT). The exemption extends to grounds of up to half a hectare provided this is not used for any other purpose. There must also be clear evidence of occupation as a main residence and not just ownership.

Tax Planning

Larger grounds may also be exempt, as can the sale of part of the garden or grounds for development. However, professional advice is recommended to plan for the best outcome.

Certain periods of absence from the property can be deemed to be periods of occupation and as such, can count towards the exemption from CGT. Prior to 6 April 2020 letting relief gave up to £40,000 (£80,000 for a couple who jointly own the property) to someone letting part or all of a property which was their main residence or was their former main residence at some point in their period of ownership. However under the revised rules letting relief is only available where the owner and tenant share occupancy.

More than one residence

Where an individual (or married couple) has two or more residences, only one residence at any one time can be treated as the main home for exemption. This is done by an election. Provided a particular residence has been the main residence at some time, then generally the last

nine months of ownership is exempt. This applies even if another residence has become the main residence during this time.

Example

Joe's house in Luton is his principal private residence, which he has owned for eight years. Fed up with commuting he buys a flat in central London and elects for this to be his main residence. Exactly five years later he sells his home in Luton.

The Luton home is exempt for the first eight years whilst he was living in it and for the last nine months because, even though he had another home which was his main residence during this time, the last nine months is always exempt provided the home in question qualified as the main residence at some point.

8.75/13 of the gain on the Luton home will be exempt from CGT. Upon the eventual sale of the flat the whole of that gain will also be exempt.

The main residence exemption and letting relief can be complex. Please contact us for further advice before making transactions in property.

Inheritance tax (IHT)

The general growth in house prices has caused real IHT worries because retaining the family home in the estate when it is often the largest asset could result in an IHT liability of up to 40%. At the same time, finding a way to deal with it efficiently for IHT is difficult because individuals need a place to live.

The Residential Nil Rate Band (RNRB) is an additional nil rate band which may be available where a residence is passed on death to direct descendants such as a child or a grandchild. This band is £175,000 in 2020/21. The additional band can only be used in respect of one residential property which has, at some point, been a residence of the deceased.

Any unused nil rate band may be transferred to a surviving spouse or civil partner.

Lifetime ISA

The Lifetime ISA, provides a tax free savings account for those wanting to save for later life or for first time buyers wishing to save for a home.

The Lifetime ISA can be opened by those aged between 18 and 40. Each person can save up to £4,000 each year up until the age of 50, and receive a government bonus of 25% (a bonus of up to £1,000 a year). The bonus is paid at the end of each tax year and savers can use some or all of the money to buy their first home.

Help to Buy ISAs are no longer available to open, however, existing account holders can continue to save into them. The scheme provides a government bonus to each person who has saved into a Help to Buy ISA at the point the purchase of their first home is completed. For every £200 a first time buyer saves, the government will provide a £50 bonus up to a maximum bonus of £3,000 on £12,000 of savings

Those with accounts can keep saving until 30 November 2029 when accounts will close to additional contributions. An individual must claim their bonus by 1 December 2030.

Disposals and capital gains tax

Making the most of your investments requires some understanding that CGT arises on the sale of most assets and, subject to various reliefs and exemptions, is payable on the difference between the sale proceeds and the original cost. Where property has been improved then these capital costs may be available to reduce the value of the gain.

The CGT annual exemption results in the first £12,300 of gains, for 2020/21, being tax free.

In general CGT is payable at 10% where total taxable gains and income, after taking into account all allowable deductions are less than the income tax basic rate band. CGT is payable at 20% on gains, or any parts of gains, above this limit. However, higher rates (18% and 28%) apply for chargeable gains on residential property that do not qualify for private residence relief.

New reporting and payment requirement

From 6 April 2020 those liable to CGT on a residential property disposal must send a standalone online return to HMRC and make a payment on account of the tax due within 30 days of completion of the sale. Transactions completed from 1 July 2020 onwards will receive a late filing penalty if they are not reported within 30 calendar days. Interest will accrue if the tax remains unpaid after 30 days.

Entrepreneurs' Relief

ER may be available on the first £1 million gains from the disposal of certain businesses during an individual's lifetime. Qualifying gains are taxed at a 10% rate of tax. Qualifying business disposals include:

- qualifying shareholdings (see the 5% rules below for more details)
- the whole or part of an unincorporated business
- the disposal of assets on cessation of a business.

For disposals on or after 6 April 2019, there needs to be a qualifying period of ownership of two years up to the date of disposal.

Where an individual makes a qualifying business disposal, relief may also be available on an 'associated disposal'. An 'associated disposal' is a disposal of an asset which is: used in a qualifying company of the individual; or used in a partnership, where the individual is a partner.

The 5% rules for company shareholders

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

- be a company employee or office holder
- hold at least 5% of the company's ordinary share capital and

- be able to exercise at least 5% of the voting rights.

An individual must also satisfy either:

- the distribution tests which require them to be entitled to at least 5% of the company's profits available for distribution and 5% of the assets available for distribution in a winding up; or
- a proceeds test which requires them, in the event of disposal of the whole of the share capital of the company, to be beneficially entitled to at least 5% of the proceeds.

Investors' Relief

A 10% CGT rate applies to external investors (ie not employees or officers of the company) in unlisted trading companies. Conditions apply:

- shares must be newly issued and subscribed for by the individual for new consideration
- be in an unlisted trading company, or an unlisted holding company of a trading group
- have been issued by the company on or after 17 March 2016 and have been held for a period of three years from 6 April 2016
- have been held continuously for a period of three years before the disposal.

An individual's gains for investors' relief will be subject to a lifetime cap of £10 million.

Preserving the inheritance

Inheritance tax (IHT) has some unique features and it is easy to collect because the authorities meet with least resistance. However, it is relatively easy for wealthy taxpayers to at least minimise the liability, if not avoid it altogether, and consequently IHT is sometimes referred to as a voluntary tax.

Nonetheless, planning to minimise IHT is something that many put off until it is too late and early attention to this tax is almost always worthwhile.

The threshold for IHT (also called the nil rate band) is currently frozen at £325,000 until 6 April 2021. Many estates fall within the charge to IHT and even if your assets are worth less than this you should consider making a Will so that you choose who gets your assets after your death.

Key features:

- IHT is charged on a person's estate when they die and on certain gifts made during their lifetime

- the rate of tax on death is 40% and 20% on lifetime chargeable transfers. The first £325,000 is not chargeable
- many lifetime gifts are treated as 'potentially exempt transfers' (PETs). So long as the donor lives for at least seven years after making the PET there will be no possibility of an IHT charge whatever the size of the gift
- there are numerous exemptions and reliefs.

So what's the problem?

IHT is still a problem because:

- many are simply not in a position to make substantial lifetime gifts because it will leave them with insufficient capital to live on. As a consequence there is likely to be significant value retained in estates on death.
- despite the introduction of the residential property nil rate band, which gives some measure of relief, many individuals have a home which will use up the bulk of the nil rate band and any excess remaining assets, such as investments and cash reserves, may be charged to IHT at 40%.

Mitigating the liability

Do not waste your exemptions. Regularly using IHT exemptions will build up funds outside of the estate without incurring an IHT liability.

Spouses/civil partners can each take advantage of the exemptions, the main ones being:

- an annual allowance of £3,000 per donor per year. This can be carried forward for one year only if unused
- small gifts not exceeding £250 in total per donee per tax year
- gifts made out of surplus income that are typical and habitual
- gifts made in consideration of marriage up to £5,000 if made by a parent, £2,500 by grandparents and £1,000 by others
- gifts to charities whether made during lifetime or on death
- gifts between spouses and registered civil partners, whether made during lifetime or on death.

Planning in lifetime

If possible you should make absolute gifts in lifetime. A gift to an individual will be a PET so there will be no liability if the donor survives seven years. Even if the donor fails to survive for all of that period there may be a tax saving



because the charge which will arise on the PET will be based on the value of the asset when it was originally gifted and not on the value at the date of death. If the value of the gift is below the threshold there will be no charge on the PET but the gift will use up some of the nil rate band on death. This means that there may be more tax to pay on the assets still in the estate on death.

Tax Planning

Each spouse/civil partner can take advantage of the IHT nil rate band. Furthermore, gifts between them are exempt (but with special rules for non-UK domiciles). Therefore it pays to use this exemption to broadly equalise estates so that both partners can make full use of exemptions and the nil rate band.

Remember that you cannot continue to benefit in any way from the asset gifted because this will render the gift ineffective for IHT purposes. You cannot, for example, give away your home to your children but continue to live in it rent free.

Use available reliefs

Important reliefs of up to 100% are available on business assets such as shares in a family trading company or on agricultural property. It is important that these reliefs are utilised because once the asset concerned is sold the relief will be lost. They can only be used in connection with transfers that are chargeable to IHT.

In lifetime it may be worth considering transfers of such assets into trusts for members of the family.

On death such assets should not automatically be left to the surviving spouse because that transfer will be exempt and, if the survivor subsequently sells the asset, the relief will have been wasted.

Consider using trusts

As stated previously, many lifetime gifts are PETs. So if the donor lives for at least seven years after making the gift the PET is removed from any charge to IHT on death. However, the donor ceases to have any control over what the beneficiary does with the gift.

This is where trusts can be useful. Most transfers into trust are immediately chargeable to IHT but if the value of the assets transferred into trust within a seven year period is below the nil rate band, there is no charge. The assets (and their subsequent growth in value) are removed from the donor's estate.

The rules are complex but significant tax savings can be achieved with careful planning. Trusts can also be an effective way of using important reliefs on businesses and agricultural properties.

Tax Planning

Using trusts can provide an effective means of removing assets from an estate but still allow flexibility in their ultimate destination and allow the donor to retain some control.

Use the nil rate band on death

On death, assuming the nil rate band has not already been utilised in the last seven years, it pays to ensure that it is not wasted. This gave rise to practical problems in that if assets equal to the nil rate band were bequeathed to children in the Will, the surviving partner may be left short of funds. The rules were therefore altered several years ago to allow any unused nil rate band on the death of the first spouse to be transferred to the estate of the surviving spouse. The transferred nil rate band can only be used against the estate of the second spouse on death.

Example

Tom died leaving the whole of his estate of £800,000 to his wife Pru. A few years later Pru died leaving her whole estate of £900,000 to her children.

Under the current rules, the portion of any nil rate band unused on the death of Tom will be allowable against Pru's estate. In this case as Tom's estate was left to Pru, none of his nil band was utilised, so 100% is available. This is in addition to Pru's own nil rate band. Using the current rates the IHT payable on Pru's death is based on £250,000 (£900,000 - [£325,000 x 2]).

Use the main residence nil rate band

An additional nil rate band may be available where a residence is passed on death to direct descendants such as a child or a grandchild. This band is £175,000 in 2020/21. The additional band can only be used in respect of

one residential property which has, at some point, been a residence of the deceased.

Any unused nil rate band may be transferred to a surviving spouse or civil partner.

The additional nil rate band is also available when a person downsizes or ceases to own a home on or after 8 July 2015 and assets of an equivalent value, up to the value of the additional nil rate band, are passed on death to direct descendants.

There is also a tapered withdrawal of the additional nil rate band for estates with a net value (after deducting any liabilities but before reliefs and exemptions) of more than £2 million. The withdrawal rate is £1 for every £2 over this threshold.

Charitable giving

Legacies to registered charities will reduce the value of the chargeable estate and thus save 40% IHT. In addition the legacies may result in a lower IHT liability on the estate which remains chargeable.

A reduced rate of IHT applies where 10% or more of a deceased's net estate (after deducting IHT exemptions, reliefs and the nil rate band) is left to charity. In those cases the 40% rate will be reduced to 36%.

Make a Will

If you die without a Will, the intestacy provisions will apply and may result in your estate being distributed in a way you would not have chosen. Keep your Will up to date to reflect changes in the family situation. In particular, Wills need to be reviewed and amended as necessary on marriage or on divorce. The precise position depends on whether English or Scots law applies.

Use life assurance

Life assurance arrangements can be used as a means of removing value from an estate and also as a method of funding IHT liabilities. A policy can be arranged to cover IHT due on death. It is particularly useful in providing funds to meet an IHT liability where the assets are not easily realised, eg family company shares.

Tax Planning

- ✓ Do you have a Will?
- ✓ Where is it kept - do you and your family know?
- ✓ Is it up to date?
- ✓ Does your Will make full use of IHT exemptions and reliefs - in particular does it take account of the new main residence nil rate band?
- ✓ Do you have adequate life assurance?

Signature



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