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Making the most of your allowances

The start of the tax year saw an increase in tax allowances for many. It is important to ensure that you take advantage and maximise your own and your family's entitlements.

Arranging your income levels is probably more achievable in a family business, for example, by reviewing the level of salary, bonus and dividend payments and their timing to ensure that full advantage is taken.

Personal Allowance £8,105 - use it or lose it

Ensure that family members utilise their personal allowances wherever possible.

Can you have too much income?

Remember if you have income in excess of £100,000 your entitlement to the personal allowance is restricted by £1 for every £2 of income in excess of the threshold. For the current tax year this means that no personal allowance is available where your income exceeds £116,210. So when planning to take income from a family business bear this in mind.

Capital gains annual exemption

The annual exemption for capital gains tax purposes has been frozen at £10,600 for this tax year. Again, ensure that where possible all family members take advantage of the exemption as it cannot be carried forward.

Do contact us for other tax saving ideas.

SUMMER 2012

A haven of success

Business Property Relief (BPR) at 100% of the value of the business or shares is a very important relief for inheritance tax (IHT) purposes.

The relief is not available where the activity does not amount to a business. Where there is a business it cannot exist wholly or mainly for the holding of investments.

This means that HMRC have always strongly resisted claims for BPR on pure property letting, on the basis that it is an 'investment' and they have generally found strong support from the Courts. There has been debate, however, on the issue of BPR and furnished holiday lets and a recent case has seen victory for the taxpayer.

The battleground was a nice bungalow in Suffolk with direct access to the beach and accommodation for 11 people to enjoy the local delights. Basically, HMRC argued that the letting of this property by the late owner was not a business and, if it was, then it was just an investment and so BPR was not available on her death.

The Tribunal judge considered the case law precedent which identifies six features of a business. He pointed out that, contrary to the view of HMRC, it was not necessary to have all six features in place but then proceeded to identify all of them as being present in the specific case. He considered that there was a business being conducted on proper lines over a reasonable period of time. It was making a good level of income (£16,000 gross in the final year) and was providing the types of supplies to customers which were expected in that type of business.

On the issue of investment, HMRC found little shelter as the judge summed up as follows: '...an intelligent businessman would not regard the ownership of a holiday letting property as an investment as such and would regard it as involving far too active an operation for it to come under that heading. The need to constantly find new occupants and to provide services unconnected with and over and above those needed for the bare upkeep of the property as a property, lead us to conclude that no postulated intelligent businessman would consider such a property as Fairhaven to be correctly characterised as an investment. He would consider it to be a business asset to be exploited as part of the provision of services going well beyond investment as such.'

Please do contact us if you would like further information or a review of whether BPR could be available to you.

A change for the worse

When the time comes to dispose of the company business and enjoy a hard earned retirement you will clearly want to do this as tax efficiently as possible. Even where a cash sale to a third party is available, a purchaser may prefer to acquire the 'assets and trade' of the company rather than the shares. This would result in cash balances in the company after the sale which would then have to be extracted.

Where there is no third party to buy the business then after ceasing to trade the company will settle any outstanding liabilities, dispose of the assets and again consider the best possible method of extracting the cash available.

Extracting the cash then generally becomes a tax issue about whether income or capital treatment is the preferred option. Over the years the choice between the two has varied depending on the tax rates in force for income tax and capital gains tax (CGT).

Currently income extraction would generally only be preferred to the extent that the taxpayer has not yet used the total of their personal allowance and basic rate band (BRB). This is because dividend extraction for a basic rate taxpayer does not trigger any further personal tax liability (though the company will have paid corporation tax on the profits at some point in the past). For 2012/13 this means than an individual with £22,475 gross income already could receive a cash dividend of £18,000 (treated as £20,000 for gross income purposes) without any tax becoming due on the dividend extracted. Furthermore, national insurance is not due on a dividend.

Once the taxpayer has used up their BRB additional tax will be due on any further income extractions. As a minimum this will equate to 25% of any dividend received. So will you fare better with CGT?

Capital extraction

CGT is levied on individuals at three rates:

- 18% if the individual has any BRB remaining after using it for income
- 28% once the BRB is used
- 10% where Entrepreneurs' Relief (ER) applies.

ER will apply to a qualifying capital extraction or sale of shares where the company is an eligible trading company, the shares have been held for at least one year prior to disposal and where the individual owns at least 5% of the ordinary voting shares of the company. This will clearly be the favoured route, where it is available, once the BRB is exhausted but it relies on achieving a capital 'distribution'.

For many years when a capital outcome was desired family owned companies were able to take advantage of an extra statutory concession commonly known as ESC C16, to obtain such a capital distribution.

It enabled a company, once it had ceased business and paid off its creditors, to close down a company informally, but without the necessity to have a formal liquidation for tax purposes. This saved both the administration and the costs involved in going through a formal liquidation (known as winding up procedures) under the Companies Act.

The significance for tax purposes is that any distribution of profit is primarily treated as an income payment unless made as part of a liquidation. However, ESC C16 used to allow a distribution in these informal circumstances to be treated as the equivalent of a distribution in a liquidation.

Change of law

Unfortunately, this well used concession has now been abolished. From 1 March 2012 a new law still permits a company to shut down under the Companies Act without a formal liquidation but it will not be possible to get capital extraction treatment for the profits distributed where they exceed £25,000. The restriction does not include the repayment of the original share capital itself.

In addition, it will be necessary, within two years of making the qualifying capital distribution, to ensure that the company:

- has been dissolved during that time and
- that it has collected in all sums due to the company and
- that it has settled all of its debts and liabilities.

Otherwise, the distribution will be classed as income and adjustments will be retrospectively made to correct the position.

Who does the change really affect?

The cost of a formal liquidation will vary depending on the size of the company and the complexities involved but can involve several thousand pounds. Clearly, where distributable profits are substantial, the overall cost effect is not damaging. However, for the smaller owner managed business company looking to close down or sell the business of the company (rather than sell the shares), where profits are not substantially in excess of £25,000, this is truly an extra cost burden. A plan for extracting dividends up to BRB capacity over a reasonable time period could be considered to reduce profits to the £25,000 limit before the business is sold or closed down.

Please contact us to assess the right course and timing of action for you and your business if you have short to medium term plans for making a disposal of your company business or its shares, so that the best outcome for your circumstances can be determined.

Accessible finance

The National Loan Guarantee Scheme (NLGS) was launched by the Government on the eve of Budget 2012 following initial proposals made in the last Autumn Statement. The aim is to help smaller businesses access cheaper finance. As such, it does not provide security on the individual loans that the banks lend to small businesses but the Treasury will underwrite the bonds issued to raise funds for business lending. This will enable the participating banks to borrow more cheaply. A business which then takes out an NLGS loan will receive a discount of 1% on the interest rate ordinarily payable, to that bank outside the scheme. Other key features of the scheme are listed below:

- An eligible business includes those with a turnover (group basis if relevant) not exceeding £50 million.
- The Government has not set minimum or maximum loans that may be made under the scheme, although each participating bank may have its own rules and some loans may be classified as State Aid. This means that a business may not receive more than EUR 200,000 worth of State Aid over any three year period.
- NGLS loans must be for a minimum of one year.
- Finance can be in the form of new term loans, hire purchase and leasing arrangements. Refinancing of existing facilities where the term or amount has changed is also permitted. Precisely which products are to be offered will be determined by each bank but the discount will not be offered on overdrafts, revolving credit, invoice finance and business credit cards.

Further information

The participating banks are Barclays, Bank of Scotland, Lloyds TSB, NatWest, RBS Santander and Aldermore. Full details of the loans offered by all the participating banks may be accessed from www.hm-treasury.gov.uk/nlgs.htm

State Benefits for having kids

- not if you earn £50,000

Child Benefit is currently paid to anyone with a child under 16, or aged 16 -19 if they are in relevant education or training. The amount is £20.30 a week for one child and £13.40 a week for each subsequent child. The benefit is not currently means tested although this is set to change.

Changes ahead

For taxpayers who have income in excess of £50,000, where either they or their partner (who are living together) is in receipt of Child Benefit, a new tax charge is to be introduced from 7 January 2013. The effect of the charge is to claw back some or all of the benefit payable.

How does the clawback work?

The clawback will apply at a rate of 1% of the full Child Benefit award for each £100 of income between £50,000 and £60,000. The income considered for this calculation is adjusted net income, broadly gross taxable income from all sources reduced by losses and specific reliefs such as Gift Aid and pension payments. The charge on taxpayers with income above £60,000 will be equal to the amount of the Child Benefit paid. Where both partners have income in excess of £50,000 the charge will apply to the partner with the higher income.

Other options and considerations

Child Benefit claimants will be able to decide not to receive Child Benefit if they or their partner do not wish to pay the new charge.

However, it is recommended that a claim is still made (even where no benefit is receivable) where a partner is at home caring for a child/children under 12. This is to ensure that the individual's entitlement to National Insurance Credits continues as these contribute towards obtaining a State Retirement pension.

Please contact us if you would like more information about this issue.

Capital Allowances - changes ahead for cars

The cost of acquiring capital equipment in a business is not a tax deductible expense. Instead, tax relief is available on certain capital expenditure in the form of capital allowances.

The allowances available depend on the type of equipment acquired and are not generally affected by the way in which the business pays for the purchase.

Plant and machinery

This includes items such as machines, equipment, furniture, computers, cars, vans and similar equipment that are used in a business.

- Expenditure on all items of plant and machinery are pooled, rather than each item being dealt with separately, with most items being allocated to a main rate pool. However, assets which are used partly for private purposes by a sole trader or an individual partner in a partnership are allocated to a single asset pool to enable a private use adjustment to be made.
- A writing down allowance (WDA) on the general pool of 18% (previously 20%) is available on any expenditure incurred in the current period either not covered by the Annual Investment Allowance (AIA) of £25,000 or not eligible for AIA. WDA also applies to the balance of expenditure remaining from earlier periods.
- Certain expenditure on fixtures in buildings, known as integral features, is only eligible for an 8% WDA (previously 10%) so is allocated to a separate special rate pool. Certain cars are also allocated to this pool.

Special rules for cars

Vehicles generally are treated as main rate pool plant and machinery and so qualify for AIA but cars are not eligible for the AIA. The treatment of car expenditure acquired from 1 April 2009 for companies and 6 April 2009 for unincorporated businesses is based on the CO_2 emissions of the car and is summarised in the table below. Pre April 2009 acquisitions (not dealt with here) were generally dependent on cost.

Although a car cannot qualify for AIA, a special 100% first year allowance (FYA) is available on new low emission cars purchased (not leased) before 31 March 2013 by a business. This is generally available where a car's emissions do not exceed 110 grams per kilometre (gm/km).

Type of car purchase	Allocate	Allowance
New low emission car not exceeding 110gm/km CO_2	General pool	100% allowance
Not exceeding 160 gm/km CO_2 emissions	General pool	18% WDA (previously 20%)
Exceeding 160 gm/km CO_2 emissions	Special rate pool	8% WDA (previously 10%)

Changes ahead

Legislation will be introduced next year to reduce the CO_2 threshold for a main rate pool car attracting the 18% rate. This will reduce to 130gm/km to match EU emissions targets for 2020 and looks set to apply to cars acquired from 1 April 2013 for companies and 6 April 2013 for unincorporated businesses.

The availability of the 100% FYA on new low emission cars will be extended for a further two years for purchases from April 2013 but only where emissions do not exceed 95gm/km.

From April 2013 Type of car purchase	Allocate	Allowance
New low emission car not exceeding 95gm/km CO_2	Main rate pool	100% allowance
Not exceeding 130 gm/km CO_2 emissions	Main rate pool	18% WDA
Exceeding 130 gm/km CO_2 emissions	Special rate pool	8% WDA

The reduced tax relief on car acquisitions is clearly not good news but the effect can be deferred by making purchases before April 2013 or consider leasing alternatives for higher emission cars, as 85% of the cost can be deducted for tax.

Restricting reliefs

Budget 2012 announced the intention that, from 6 April 2013, there will be limits to the amount of income tax relief that individuals can claim.

This is driven by the fact that, currently individuals can relieve their entire income through the use of income tax reliefs and as a result pay no income tax at all. From a common sense view point this does beg the question as to how they manage to live at all but that is a separate matter. From a Government perspective the concern is only to ensure that those with high incomes pay their share of tax as stated below:

'However, some individuals on very high incomes have used reliefs to pay little or no tax, sometimes year after year. This Government believes it is not right that taxpayers with very high incomes should, year on year, pay little or no tax as a result of unlimited reliefs.

Other countries already restrict tax reliefs. For example the US caps the income tax relief available for charitable donations, and there is a presumption that all taxpayers should contribute to Government costs. In the US, it is not possible to reduce income tax bills to zero by making donations to charity, as is currently possible in the UK.'

The outline proposal

The proposed cap is the greater of 25% of income or £50,000. It is only set to apply to reliefs which are currently unlimited. The principal reliefs affected would seem to include:

- loss reliefs that can be claimed against total income
- qualifying loan interest relief and
- reliefs for charitable giving.

Example

This means that for 2013/14 onwards an individual with an income of £280,000 would only be able to offset £70,000 against their income, either through giving to charity or through some other relief such as business losses, up to that amount. The maximum tax saving in such a situation would, for an additional rate taxpayer for 2013/14, be at the rate of 45%.

In 2012/13 and earlier tax years any such reliefs would have been available to reduce income potentially to nil or at least by such an amount as to avoid the current additional rate tax of 50%. In this example, it would mean that £130,000 could be used to reduce taxable income to £150,000 so that only basic and higher rate tax was due.

Reliefs that are already capped such as pension contributions, Enterprise and Seed Enterprise Investment Scheme (EIS) income tax relief, Venture Capital Trusts and the Cultural Gifts Scheme are not affected. This does provide some potential alternatives for the high income individual to consider.

So, returning to the example above for 2013/14, the individual will be able to obtain further IT relief where for example, a qualifying investment was made in an EIS company, as this relief is already capped and should not be affected by the new proposals.

Impact on charities

There is clearly concern about the impact these proposals will have on charities. In response to this the Government has stated that:

'it is committed to exploring with the philanthropy and charity sectors ways to ensure that this change does not significantly impact on charities which depend on large donations.'

The cap will not, however, impact on the tax reclaimed by charities under the Gift Aid scheme. However, the grossed up donation (that is the donation made by the donor plus the tax reclaimed by charities) will be taken into account when assessing whether an individual donor has reached the cap.

Example

An individual with income of £500,000 makes a net donation of £120,000 to charity. The gross donation is £150,000 once the 20% basic rate tax of £30,000 is added. The charity will be entitled to receive the £30,000 basic rate tax in full from HMRC. However, the individual will only get tax relief on £125,000 (£500,000 x 25%) of the £150,000 under the proposals.

What next?

Some planning may be necessary for affected individuals before 2013/14 particularly if tax relief of 50% is currently available before:

- the additional rate reduces to 45% and
- the affected reliefs are capped.

Further details of how the cap will be implemented are expected when the consultation document is issued. We will keep you informed of developments but please do contact us if you consider this will impact upon you, so that any relevant action points can be explored.

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