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bright ideas.

A look at...

Corporate & Business Tax

2017

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BUSINESS MOTORING – TAX ASPECTS

The following focuses on the current tax position of business motoring, a core consideration of many businesses. The aim is to provide a clear explanation of the tax deductions available on different types of vehicle expenditure in a variety of business scenarios.

Methods of acquisition

Motoring costs, like other costs incurred which are wholly and exclusively for the purposes of the trade are tax deductible but the timing of any relief varies considerably according to the type of expenditure. In particular, there is a fundamental distinction between capital costs and ongoing running costs.

Purchase of vehicles

Where vehicles are purchased outright, the accounting treatment is to capitalise the asset and to write off the cost over the useful business life as a deduction against profits. This is known as depreciation.

The same treatment applies to vehicles financed through hire purchase with the equivalent of the cash price being treated as a capital purchase at the start with the addition of a deduction from profit for the finance charge as it arises. However, the tax relief position depends primarily on the type of vehicle, and the date of expenditure.

A tax distinction is made for all businesses between a normal car and other forms of commercial vehicles including vans, lorries and some specialist forms of car such as a driving school car or taxi.

Tax relief on purchases

Vehicles which are not classed as cars are eligible for the Annual Investment Allowance (AIA) for expenditure incurred. The AIA provides a 100%

deduction for the cost of plant and machinery purchased by a business up to an annual limit. The amount of AIA available varies depending on the period of the accounts. The current amount of AIA is £200,000 and prior to 1 January 2016 was £500,000.

Where purchases exceed the AIA, a writing down allowance (WDA) is due on any excess in the same period. The WDA available is currently at a rate of 18% or 8% depending on the asset. Cars are not eligible for the AIA, so will only benefit from WDA.

Capital allowance boost for low-carbon transport

A 100% first year allowance is currently available for capital expenditure on new electric vans.

Writing Down Allowances (WDA)

The writing down allowance rates are 18% on the main rate pool and 8% which applies to many higher emission cars which are part of the special rate pool.

Complex cars!

The green car

Cars generally only attract the WDA but there is one exception to this and that is where a business purchases a new car with low emissions - a so called 'green' car. Such purchases attract a 100% allowance to encourage businesses to purchase cars which are more environmentally friendly. From April 2015 a 100% write off is only available where the CO₂ emissions of the car do not exceed 75gm/km (reducing to 50gm/km from April 2018). The cost of the car is irrelevant and the allowance is available to all types of business.

When did you buy?

There have been significant changes to the basis of capital allowances for car

purchases and the tax relief thereon. The allowances due are determined by whether the car was purchased

- from April 2018 (proposed)
- from April 2015 to April 2018
- or between April 2013 and April 2015
- or between April 2009 and April 2013.

The dates are 1 April for companies and 6 April for individuals in business.

For purchases from April 2018:

The annual allowance is dependent on the CO₂ emissions of the car.

Cars with emissions between 51 – 110 gm/km inclusive will qualify for main rate WDA.

Cars in excess of 110 gm/km are placed in the special rate pool and will qualify for an annual WDA of 8%.

The 100% first year allowance (FYA) will be available on new low emission cars purchased (not leased) by a business is generally available where a car's emissions do not exceed 50 gm/km.

If a used car is purchased with CO₂ emissions of 50gm/km or less, this will be placed in the main pool and will receive an annual allowance of 18%.

For purchases from April 2015 to April 2018:

Cars with emissions between 76 – 130 gm/km inclusive currently qualify for main rate WDA.

Cars in excess of 130 gm/km are placed in the special rate pool and will qualify for an annual WDA of 8%.

The 100% first year allowance (FYA) available on new low emission cars purchased (not leased) by a business is generally available where a car's emissions do not exceed 75gm/km.

If a used car is purchased with CO₂ emissions of 75gm/km or less, this

will be placed in the main pool and will receive an annual allowance of 18%.

For purchases from April 2013 to April 2015:

Cars with emissions between 96 – 130gm/km inclusive qualify for main rate WDA.

Cars in excess of 130 gm/km are placed in the special rate pool and will qualify for an annual WDA of 8%.The 100% first year allowance (FYA) available on new low emission cars purchased (not leased) by a business is generally available where a car's emissions do not exceed 95 gm/km.

If a used car is purchased with CO₂ emissions of 95gm/km or less, this will be placed in the main pool and will receive an annual allowance of 18%.

For purchases from April 2009 to April 2013:

The annual allowance is dependent on the CO₂ emissions of the car.

- Cars between 111 - 160 gm/km are placed in the main rate pool and will qualify for an annual WDA of 18%.
- Cars in excess of 160 gm/km are placed in the special rate pool and will qualify for an annual WDA of 8%.

If a used car is purchased with CO₂ emissions of 110 g/km or less, this will be placed in the main pool and will receive an annual allowance of 18%.

Non-business

Any cars used by the self employed where there is part non-business use will still be separately allocated to a single asset pool. The annual allowance will initially be either the current 18% or 8% depending on the CO₂ emissions and

then the available allowance will be restricted for the private use element.

Example

A company purchases two cars for £20,000 in its 12 month accounting period to 31 March 2017. The dates of purchase and CO₂ emissions are as follows:

White car	Blue car
1 May 2016	1 May 2016
125	145

Allowances in the year to 31 March 2017 relating to these purchases will be:

White car (main pool as emissions less than 130)	Blue car (special rate pool as emissions more than 130)
£20,000 @ 18% = £3,600	£20,000 @ 8% = £1,600

In the following year to 31 March 2018 the allowances will be:

White	Blue
£16,400 @ 18% = £2,952	£18,400 @ 8% = £1,472

Disposals

Where there is a disposal of plant and machinery from the main or special rate pools any balance of expenditure, after taking into account sale proceeds, continues to attract the annual allowance.

Where there is a disposal of a car held in a single asset pool, the disposal proceeds are deducted from the balance of the pool and a balancing allowance or a balancing charge is calculated to clear the balance on the pool.

This applies to any cars used by the self-employed with part non business use whenever purchased.

What if vehicles are leased?

The first fact to establish with a leased vehicle is whether the lease is really a rental agreement or whether it is a type of purchase agreement, usually referred to as a finance lease. This is because there is a distinction between the accounting and tax treatment of different types of leases.

Tax treatment of rental type operating leases (contract hire)

The lease payments on operating leases are treated like rent and are deductible against profits. However where the lease relates to a car there may be a portion disallowed for tax. Currently a disallowance of 15% will apply for cars with CO₂ emissions which exceed 130gm/km.

Example

Contract signed 1 April 2017 by a company:
The car has CO₂ emissions of 136 gm/km and a £6,000 annual lease charge. The disallowed portion would be £900 (15%) so £5,100 would be tax deductible.

Tax treatment of finance leased assets

These will generally be included in your accounts as fixed assets and depreciated over the useful business life but as these vehicles do not qualify as a purchase at the outset, the expenditure does not qualify for capital allowances unless classified as a long funded lease. Tax relief is generally obtained instead by allowing the accounting depreciation

and any interest/finance charges in the profit and loss account – a little unusual but a simple solution!

Private use of business vehicles

The private use of a business vehicle has tax implications for either the business or the individual depending on the type of business and vehicle.

Sole traders and partners

Where you are in business on your own account and use a vehicle owned by the business – irrespective of whether it is a car or van – the business will only be able to claim the business portion of any allowances. This applies to capital allowances, rental and lease costs, and other running costs such as servicing, fuel etc.

Providing vehicles to employees

Where vehicles are provided to employees irrespective of the form of business structure – sole trader/partnership/company – a taxable benefit generally arises for private use. A tax charge will also apply where private fuel is provided for use in an employer provided vehicle. For the employer such taxable benefits attract 13.8% Class 1A National Insurance.

Vans

No charge applies where employees have the use of a van and a restricted private use condition is met. For details on what this means please contact us. Where the condition is not met there is a flat rate charge per annum. These benefits are £3,230 for the unrestricted private use plus an additional £610 for private fuel 2017/18 (£3,170 and £598 for 2016/17).

How we can help

If you would like further details on any matter contained in this factsheet please contact us.

CAPITAL ALLOWANCES

Overview

The cost of purchasing capital equipment in a business is not a revenue tax deductible expense. However tax relief is available on certain capital expenditure in the form of capital allowances.

The allowances available depend on what you are purchasing. Here is an overview of the types of expenditure which qualify for capital allowances and the amounts available.

Capital allowances are not generally affected by the way in which the business pays for the purchase. So where an asset is acquired on hire purchase (HP), allowances are generally given as though there were an outright cash purchase and subsequent instalments of capital are ignored. However finance leases, often considered to be an alternative form of 'purchase' and which for accounting purposes are included as assets, are denied capital allowances. Instead the accounts depreciation is usually allowable as a tax deductible expense.

Any interest or other finance charges on an overdraft, loan, HP or finance lease agreement to fund the purchase is a revenue tax deductible business expense. It is not part of the capital cost of the asset.

If alternatively a business rents capital equipment, often referred to as an operating lease, then as with other rents this is a revenue tax deductible expense so no capital allowances are available.

Plant and machinery

This includes items such as machines, equipment, furniture, certain fixtures, computers, cars, vans and similar equipment you use in your business. Note there are special rules for cars and certain 'environmentally friendly' equipment and these are dealt with below.

Acquisitions

The Annual Investment Allowance (AIA) provides a 100% deduction for the cost of most plant and machinery (not cars) purchased by a business up to an annual limit and is available to most businesses. Where businesses spend more than the annual limit, any additional qualifying expenditure generally attracts an annual writing down allowance of only 18% or 8% depending on the type of asset. The maximum amount of the AIA depends on the date of the accounting period and the date of expenditure. The AIA from 1 January 2016 is £200,000. Where purchases exceed the AIA, a writing down allowance (WDA) is due on any excess in the same period. This WDA is currently at a rate of 18%. Cars are not eligible for the AIA, so will only benefit from the WDA (see special rules for cars). Please contact us before capital expenditure is incurred for your business in a current accounting period, so that we can help you to maximise the AIA available.

Pooling of expenditure and allowances due

- 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.
- A writing down allowance (WDA) on the main rate pool of 18% is available on any expenditure incurred in the current period not covered by the AIA or not eligible for AIA as well as on any balance of expenditure remaining from earlier periods.
- Certain expenditure on buildings fixtures, known as integral features (eg lighting, air conditioning, heating, etc) is only eligible for an

8% WDA so is allocated to a separate 'special rate pool', though integral features do qualify for the AIA.

- Allowances are calculated for each accounting period of the business.
- When an asset is sold, the sale proceeds (or original cost if lower) are brought into the relevant pool. If the proceeds exceed the value in the pool, the difference is treated as additional taxable profit for the period and referred to as a balancing charge.

Special rules for cars

There are special rules for the treatment of certain distinctive types of expenditure. The first distinctive category is car expenditure. Other vehicles are treated as general pool plant and machinery but cars are not eligible for the AIA. The treatment of car expenditure depends on when it was acquired and is best summarised as follows:

Acquisitions from April 2018

The government has announced the following changes to the capital allowance rules for cars.

Type of car purchase	Allocate	Allowance
New low emission car not exceeding 50g/km CO ₂	Main rate pool	100% allowance
Not exceeding 110 g/km CO ₂ emissions	Main rate pool	18% WDA
Exceeding 110 g/km	Special rate pool	8% WDA

CO ₂ emissions		

From 1 / 6 April 2015 to 31 March / 5 April 2018

The capital allowance treatment of cars is based on the level of CO₂ emissions.

Type of car purchase	Allocate	Allowance
New low emission car not exceeding 75g/km CO ₂	Main rate pool	100% allowance
Not exceeding 130 g/km CO ₂ emissions	Main rate pool	18% WDA
Exceeding 130 g/km CO ₂ emissions	Special rate pool	8% WDA

Acquisitions from April 2013 to 31 March / 5 April 2015

Type of car purchase	Allocate	Allowance
New low emission car not exceeding 95g/km CO ₂	Main rate pool	100% allowance
Not exceeding 130 g/km CO ₂ emissions	Main rate pool	18% WDA
Exceeding 130 g/km CO ₂ emissions	Special rate pool	8% WDA

Non-business use element

Cars and other business assets that are used partly for private purposes, by the proprietor of the business (ie a sole trader or partners in a partnership), are allocated to a single asset pool irrespective of costs or emissions to

enable the private use adjustment to be made. Private use of assets by employees does not require any restriction of the capital allowances.

The allowances are computed in the normal way so can in theory now attract the 100% AIA or the relevant writing down allowance. However, only the business use proportion is allowed for tax purposes. This means that the purchase of a new 70g/km CO₂ emission car which costs £15,000 with 80% business use will attract an allowance of £12,000 (£15,000 x 100% x 80%) when acquired.

On the disposal of a private use element car, any proceeds of sale (or cost if lower) are deducted from any unrelieved expenditure in the single asset pool. Any shortfall can be claimed as an additional one off allowance but is restricted to the business use element only. Similarly any excess is treated as a taxable profit but only the business related element.

Environmentally friendly equipment

This includes items such as energy saving boilers, refrigeration equipment, lighting, heating and water systems as well as cars with CO₂ emissions up to 75 gm/km (reducing to 50 gm/km from April 2018).

A 100% allowance is available to all businesses for expenditure on the purchase of new environmentally friendly equipment.

- <https://www.gov.uk/guidance/energy-technology-list> gives further details of the qualifying categories.
- where a company (not an unincorporated business) has a loss after claiming 100% capital allowances on green technology equipment (but not cars) they may be able to reclaim a tax credit from HMRC.

Short life assets

For equipment you intend to keep for only a short time, you can choose (by election) to keep such assets outside the normal pool. The allowances on them are calculated separately and on sale if the proceeds are less than the balance of expenditure remaining, the difference is given as a further capital allowance. This election is not available for cars or integral features.

For assets acquired from 1 April 2011 (6 April for an unincorporated business) the asset is transferred into the pool if it is not disposed of by the eighth anniversary of the end of the period in which it was acquired.

Long life assets

These are assets with an expected useful life in excess of 25 years. These assets are combined with integral features in the 8% special rate pool.

There are various exclusions including cars and the rules only apply to businesses spending at least £100,000 per annum on such assets so that most smaller businesses are unaffected by these rules.

Other assets

Capital expenditure on certain other assets qualifies for relief. Please contact us for specific advice on areas such as qualifying expenditure in respect of enterprise zones and research and development.

Claims

Unincorporated businesses and companies must both make claims for capital allowances through tax returns. Claims may be restricted where it is not desirable to claim the full amount available - this may be to avoid other allowances or reliefs being wasted.

For unincorporated businesses the claim must normally be made within 12 months after the 31 January filing deadline for the relevant return.

For companies the claim must normally be made within two years of the end of the accounting period.

How we can help

The rules for capital allowances can be complex. We can help by computing the allowances available to your business, ensuring that the most advantageous claims are made and by advising on matters such as the timing of purchases and sales of capital assets. Please do contact us if you would like further advice.

COMPANIES – TAX SAVING OPPORTUNITIES

Due to the ever changing tax legislation and commercial factors affecting your company, it is advisable to carry out an annual review of your company's tax position.

Pre-year end tax planning is important as the current year's results can normally be predicted with some accuracy and time still exists to carry out any appropriate action.

We outline below some of the areas where advance planning may produce tax savings.

For further advice please do not hesitate to contact us.

Corporation tax

Advancing expenditure

Expenditure incurred before the company's accounts year end may reduce the current year's tax liability.

In situations where expenditure is planned for early in the next accounting year the decision to bring forward this expenditure by just a few weeks can advance the related tax relief by a full 12 months.

Examples of the type of expenditure to consider bringing forward include:

- building repairs and redecorating
- advertising and marketing campaigns
- redundancy and closure costs.

Note that payments into company pension schemes are only allowable for tax purposes when the payments are actually made as opposed to when they are charged in the company's accounts.

Capital allowances

Consideration should also be given to the timing of capital expenditure on which capital allowances are available to obtain the optimum reliefs.

Single companies irrespective of size are able to claim an annual investment allowance which provides 100% relief on expenditure on plant and machinery (excluding cars). The amount of AIA is currently set at £200,000.

Groups of companies have to share the allowance. Expenditure on qualifying plant and machinery in excess of the AIA is eligible for writing down allowance (WDA) of 18%. Where the capital expenditure is incurred on integral features the WDA is 8%.

100% allowances on designated energy saving technologies continue to be available in addition to the annual investment allowance. Details can be found at www.etl.decc.gov.uk.

Limited allowances are also available for investments in certain types of building.

Trading losses

Companies incurring trading losses have three main options to consider in utilising these losses:

- they can be set against any other income (for example bank interest) or capital gains arising in the current year
- they can be carried forward and set against trading profits arising in future years
- they can be carried back for up to one year and set against total profits.

Proposed changes for April 2017

The government propose to make changes to the rules for corporation tax losses to make the tax relief more flexible. When losses arising on or after 1 April 2017 are carried forward, they will be available to be used against profits from different types of income in the company and other group companies. There will, however, be a restriction on the use of carry forward losses where a company's or group's profits are above

£5 million. Any profits over £5 million arising on or after 1 April 2017 cannot be reduced by more than 50% by brought forward losses. Losses that have arisen at any time will be subject to these restrictions.

Extracting profits

Directors/shareholders of family companies may wish to consider extracting profits in the form of dividends rather than as increased salaries or bonus payments.

This can lead to substantial savings in national insurance contributions.

Note however that company profits extracted as a dividend remain chargeable to corporation tax at a minimum of 19% from 1 April 2017.

Dividends

From the company's point of view timing of payment is not critical, but from the individual shareholder's perspective, timing can be an important issue. If the shareholder is a higher/additional rate taxpayer, a dividend payment which is delayed until after the tax year ending on 5 April may give the shareholder an extra year to pay any further tax due. The deferral of tax liabilities on the shareholder will be dependent on a number of factors. Please contact us for detailed advice.

Loans to directors and shareholders

If a 'close' company (broadly, one controlled by its directors or by five or fewer shareholders) makes a loan to a shareholder, this can give rise to a tax liability for the company.

If the loan is not settled within nine months of the end of the accounting period, the company is required to make a payment equal to 32.5% (25% for loans made before 6 April 2016) of the loan to HMRC. The money is not repaid to the company until nine months after the end of the accounting period in

which the loan is repaid by the shareholder.

A loan to a director may also give rise to a tax liability for the director on the benefit of a loan provided at less than the market rate of interest.

Rates of tax

From 1 April 2015 the main rate of corporation tax is 20% and this rate will continue for the Financial Year beginning on 1 April 2016. The main rate of corporation tax will then be reduced as follows:

- 19% for the Financial Years beginning on 1 April 2017, 1 April 2018 and 1 April 2019
- 17% for the Financial Year beginning on 1 April 2020.

Self assessment

Under the self assessment regime most companies must pay their tax liabilities nine months and one day after the year end.

Companies which pay (or expect to pay) tax at the main rate are required to pay tax under the quarterly accounting system. If you require any further information on the quarterly accounting system, we have a factsheet which summarises the system.

Corporation tax returns must be submitted within twelve months of the year end and are required to be submitted electronically. In cases of delay or inaccuracies interest and penalties will be charged.

Capital gains

Companies are chargeable to corporation tax on their capital gains less allowable capital losses.

Indexation allowance

In order to counteract the effects of inflation inherent in the calculation of a

capital gain, an indexation allowance is given. However the allowance is not allowed to increase or create a capital loss.

Planning of disposals

Consideration should be given to the timing of any chargeable disposals to ensure advantage is taken where possible of minimising the tax liability at small profits rate rather than full rate. This could be achieved depending on circumstances by accelerating or delaying sales. The availability of losses or the feasibility of rollover relief (see below) should also be considered.

Purchase of new assets

It may be possible to avoid a capital gain being charged to tax if the sale proceeds are reinvested in a replacement asset. The replacement asset must be acquired in the four year period beginning one year before the disposal and only certain trading tangible assets qualify for relief.

How we can help

Tax savings can only be achieved if an appropriate course of action is planned in advance. It is therefore vital that professional advice is sought at an early stage. We would welcome the chance to tailor a plan to your specific circumstances. Please do not hesitate to contact us.

CONSTRUCTION INDUSTRY SCHEME

The Construction Industry Scheme (CIS) sets out special rules for tax and national insurance (NI) for those working in the construction industry. Businesses in the construction industry are known as 'contractors' and 'subcontractors'. They may be companies, partnerships or self employed individuals.

The CIS applies to construction work and also jobs such as alterations, repairs, decorating and demolition.

Contractors and subcontractors

Contractors include construction companies and building firms and also government departments and local authorities. Any other business spending more than £1 million a year on construction is classed as a contractor for the purposes of the CIS.

Subcontractors are those businesses that carry out work for contractors.

Many businesses act as both contractors and subcontractors.

Monthly return

Contractors have to make an online monthly return to HMRC:

- confirming that the employment status of subcontractors has been considered
- confirming that the verification process has been correctly dealt with
- detailing payments made to all subcontractors and
- detailing any deductions of tax made from those payments.

The monthly return relates to each tax month (ie running from the 6th of one month to the 5th of the next). The deadline for submission is 14 days after the end of the tax month.

Where a contractor has not made any payments to subcontractors in a tax month it is advisable to make a nil return to avoid HMRC chasing the return or issuing penalties for failure to make a return.

All contractors are obliged to file monthly even if they are entitled to pay their PAYE quarterly.

Identification

Subcontractors must give contractors their name, unique taxpayer reference and national insurance number (or company registration number) when they enter into a contract. So long as the contractor is satisfied that the subcontractor is genuinely self-employed the 'verification' procedure (explained below) must be followed.

Employed or self-employed?

A key part of the CIS is that the contractor has to make a monthly declaration that they have considered the status of the subcontractors and are satisfied that none of those listed on the return are employees. HMRC can impose a penalty of up to £3,000 if contractors negligently or deliberately provide incorrect information.

Remember that employment status is not a matter of choice. The circumstances of the engagement determine how it is treated.

The issue of the status of workers within the construction industry is not a new matter and over the last few years HMRC have been making substantial efforts to re-classify as many subcontractors as possible as employees. The courts have considered many cases over the years and take into account a variety of different factors in deciding whether or not a worker is employed or self-employed. The tests which are applied include:

- the right of control over how, what, where and when the work is done;

the more control that a contractor can exercise, the more likely it is that the worker is an employee

- whether the worker provides a personal service or whether a substitute could be provided to do that work
- whether any equipment is necessary to do the job, and if so, who provides it
- the basis of payment - whether an hourly/weekly rate is paid, whether there is any overtime, sick or holiday pay and whether or not invoices are raised for the work done
- whether the worker is part and parcel of the organisation or whether they are conducting a task which is self-contained in its own right
- what the intention of the parties is - whether there is any written statement that there is no intention of an employment relationship
- whether there is a mutuality of obligation; that is, an ongoing understanding that the contractor will offer work and the worker accept it
- whether the workers have any financial risk.

As can be seen from the above, there are a number of factors which must be considered and the decision as to whether somebody should be classified as employed or self-employed is not a simple one.

Clearly, HMRC would like subcontractors to be classed as employees, as this generally means that more tax and national insurance is due. However, just because the HMRC think that somebody should be re-classified does not necessarily mean that they are correct.

HMRC have developed software known as the employment status indicator tool, which is available on their website, to address this matter but the software appears to be heavily weighted towards re-classifying subcontractors as employees. It should not be relied on and professional advice should be taken if this is a major issue for your business. Please talk to us if you have any particular concerns in this area.

Verification

The contractor has to contact HMRC to check whether to pay a subcontractor gross or net. Not every subcontractor will need verifying (see below). Usually it will only be new ones.

The verification procedure will establish which of the following payment options apply:

- gross payment
- a standard rate deduction of 20%
- a deduction made at the higher rate of 30% if the subcontractor has not registered with HMRC or cannot provide accurate details to the contractor and HMRC cannot verify them.

HMRC will give the contractor a verification number for the subcontractors which will be matched with HMRC's own computer. The number will be the same for each subcontractor verified at any particular time. There will be special suffixes for the numbers issued in respect of subcontractors who cannot be verified. The numbers are also shown on contractors' monthly returns and the payslips issued to the subcontractors. Clearly, these numbers are a fundamental part of the system and contractors have to ensure that they have a fool-proof system in place for obtaining and retaining them. It is also very important to give precise details to HMRC because, if their computer does not recognise the subcontractor, the

higher rate deduction will have to be made.

From 6 April 2017 mandatory online verification of subcontractors has been introduced.

Who needs verifying with HMRC?

If a contractor is paying a subcontractor they will not have to verify them if:

- they have already included them on any monthly return in that tax year; or
- the two previous tax years.

A payslip?

Contractors have to provide a monthly 'payslip' to all subcontractors paid, showing the total amount of the payments and how much tax, if any, has been deducted from those payments. The contractor has to provide this for each tax month as a minimum.

Contractors are allowed to choose the style of the 'payslips' themselves but certain specific information has to be provided including the:

- contractor's name and their employer tax reference
- tax month to which the payment relates
- subcontractor's name, unique tax reference or specific subcontractor reference
- the gross amount of the payment
- cost of any materials which have reduced the gross payment
- amount of any tax deductions made and
- verification number where deduction has been made at the higher rate of 30%.

If contractors include such payments as part of their normal payroll system, it needs to be clear that although payslips are being generated for those individuals, they are not employees and have clearly been classed as self-employed.

Are tax deductions made from the whole payment?

Not necessarily. The following items should be excluded when entering the gross amount of payment on the monthly return:

- VAT charged by the subcontractor if the subcontractor is registered for VAT
- any Construction Industry Training Board levy.

The following items should be deducted from the gross amount of payment when working out the amount of payment from which the deduction should be made:

- what the subcontractor actually paid for materials including VAT paid if the subcontractor is not registered for VAT, consumable stores, fuel (except fuel for travelling) and plant hire used in the construction operations
- the cost of manufacture or prefabrication of materials used in the construction operations.

Any travelling expenses (including fuel costs) and subsistence paid to the subcontractor should be included in the gross amount of payment and the amount from which the deduction is made.

Penalties

The whole system is backed up by a series of penalties. These cover situations in which an incorrect monthly return is

sent in negligently or fraudulently, failure to provide CIS records for HMRC to inspect and incorrect declarations about employment status. Late returns under the CIS scheme also trigger penalties as follows:

- a basic penalty of £100 for failure to meet due date of the 19th of the month
- where the failure continues after two months after the due date, a penalty of £200
- after six months the penalty rises to the greater of 5% of the tax or £300
- after 12 months the penalty will again be the greater of £300 or 5% of the tax but, where the withholding of information is deliberate and concealed, it will be 100% of the tax (or £3,000 if greater) and where information is withheld deliberately, 70% of tax (or £1,500 if greater)
- where the return is 12 months late but the information only relates to persons registered for gross payment, the penalty will be £3,000 for deliberate and concealed withholding of information and £1,500 for deliberate withholding without concealment
- where a person has just entered the CIS scheme penalties will be restricted to a maximum of £3,000 in certain circumstances.

Paying over the deductions

Contractors have to pay over all deductions made from subcontractors in any given tax month by the 19th following the end of the tax month to which the deductions relate. If payment is being made electronically, the date will be the 22nd, or the next earlier

banking day when the 22nd is a weekend or holiday. If the contractor is a company which itself has deductions made from its payments as a subcontractor, then the deductions made may be set against the company's liabilities for PAYE, NI and any CIS deductions it is due to pay over.

What about subcontractors?

If a subcontractor first starts working in the construction industry on a self-employed basis they will need to register for the CIS.

To register, a subcontractor needs to contact HMRC by phone or over the internet and they will conduct identity checks.

Gross payment status

The rules for subcontractors to be paid gross include a business test, a turnover test and a compliance test. To qualify for gross payment a subcontractor must:

- have paid their tax and National Insurance on time in the past
- do construction work (or provides labour for it) in the UK
- run the business through a bank account.

The turnover for the last 12 month, ignoring VAT and the cost of materials, must be at least:

- £30,000 for a sole trader
- £30,000 for each partner in a partnership, or at least £100,000 for the whole partnership
- £30,000 for each director of a company, or at least £100,000 for the whole company

If your company's controlled by 5 people or fewer, you must have an annual turnover of £30,000 for each of them. Subcontractors not registered with the HMRC will suffer the higher rate

deduction from any payments made to them by contractors.

How we can help

Please do get in touch if you would like further information about the CIS. We can advise on the CIS whether you are a contractor or a subcontractor.

CORPORATION TAX SELF-ASSESSMENT

Key features

The key features are:

- a company is required to pay the tax due in advance of filing a tax return
- a 'process now, check later' enquiry regime when the tax return is submitted
- the inclusion in the tax return, and in a single self assessment, of the liabilities of close companies on loans and advances to shareholders and others, and of liabilities under Controlled Foreign Companies legislation
- the requirement for companies to self assess by reference to transfer pricing legislation.

Practical effect of CTSA for companies

Notice to file

Every year, HMRC issue a notice to file to companies. In most cases, the return must be submitted to HMRC within 12 months of the end of the accounting period.

Filing your company tax return online

Companies must file their corporate return online. Their accounts and computations must also be filed in the correct format - inline eXtensible Business Reporting Language (iXBRL). Unincorporated organisations and charities that don't need to prepare accounts under the Companies Act can choose to send their accounts in iXBRL or PDF format. However any computations must be sent in iXBRL format.

Penalties

Penalties apply for late submission of the return of £100 if it is up to three months late and £200 if the return is over three months late. Additional tax geared penalties apply when the return is either six or twelve months late. These penalties are 10% of the outstanding tax due on those dates.

Submission of the return

The return required by a Notice to file contains the company's self assessment, which is final subject to:

- taxpayer amendment
- HMRC correction, or
- HMRC enquiry.

The company has a right to amend a return (for example changing a claim to capital allowances). The company has 12 months from the statutory filing date to amend the return.

HMRC have nine months from the date the return is filed to correct any 'obvious' errors in the return (for example an incorrect calculation). This process should be a fairly rare occurrence. In particular the correction of errors does not involve any judgement as to the accuracy of the figures in the return. This is dealt with under the enquiry regime.

Enquiries

Under CTSA, HMRC check returns and has an explicit right to enquire into the completeness and accuracy of any tax return. This right covers all enquiries, from straightforward requests for further information on individual items through to full reviews of a company's business including examination of the company's records.

The main features of the rules for enquiries under CTSA are:

- HMRC generally have a fixed period, of 12 months from the date the

return is filed, in which to commence an enquiry

- where the company is a member of a group (other than a small group), HMRC can raise an enquiry up to 12 months from the due filing date
- if no enquiry is started within this time limit, the company's return becomes final - subject to the possibility of an HMRC 'discovery'
- HMRC will give the company formal notice when an enquiry commences
- HMRC are also required to give formal notice of the completion of an enquiry, and to state their conclusions
- a company may ask the Commissioners to direct HMRC to close an enquiry if there are no reasonable grounds for continuing it.

Discovery assessments

HMRC have the power to make an assessment (a 'discovery assessment') if information comes to light after the end of the enquiry period indicating that the self assessment was inadequate as a result of fraudulent or negligent conduct, or of incomplete disclosure.

Summary of self-assessment process

Example

A company prepares accounts for the 12 months ended 31 May 2016 and submits the return by 31 December 2016. Key dates under CTSA are:
01.03.17 - Payment of corporation tax
31.05.17 - Deadline for filing the return
31.12.17 - End of period for HMRC to open enquiry (being 12 months from the date the return was actually filed)
On 31 December 2017 the company tax position is finalised subject to HMRC's right to make a discovery assessment in some circumstances.

Payment of tax

There is a single, fixed due date for payment of corporation tax, nine months and one day after the end of the accounting period (subject to the Quarterly Instalment Payment regime for large companies).

If the payment is late or is not correct, there will be late payment interest on tax paid late and repayment interest on overpayments of tax. These interest payments are tax deductible/taxable.

Credit interest

If a company pays tax before the due date, it receives credit interest on amounts paid early. Any interest received is chargeable to corporation tax.

Loans to shareholders

If a close company makes a loan to a participator (for example most shareholders in unquoted companies), the company must make a payment to HMRC if the loan is not repaid within nine months of the end of the accounting period. The amount of the tax is 32.5% of the loan for loans made

or benefits conferred on or after 6 April 2016. The tax charge is 25% of the loan for loans made prior to 6 April 2016. This increased rate mirrors the dividend upper rate. The government has noted that this will prevent individuals gaining a tax advantage by taking loans or making other arrangements to extract value from their company rather than remuneration or dividends.

Additional rules for loans to shareholders

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.

This tax is included within the CTSA system and the company must report loans outstanding to participants in the tax return.

How we can help

Do not hesitate to contact us if you require any further information.

CORPORATION TAX – QUARTERLY INSTALMENT PAYMENTS

Under corporation tax self-assessment large companies are required to pay their corporation tax in four quarterly instalment payments. These payments are based on the company's estimate of its current year tax liability.

Note that the overwhelming majority of companies are not within the quarterly payment regime and pay their corporation tax nine months and one day after the end of their accounting period.

We highlight below the main areas to consider if your company is affected by the quarterly instalments system.

Companies affected by quarterly instalment payments

Large companies

Only large companies have to pay their corporation tax by quarterly instalments. A company is large if its profits for the accounting period exceed the upper relevant maximum amount (URMA) in force at the end of that period. The URMA is £1.5 million and the rate of corporation tax is 19% from 1 April 2017.

Group companies

Where a company has one or more 51% related group companies, the URMA is reduced to the figure found by dividing that amount by one plus the number of related 51% group companies. The URMA is also proportionately reduced for short accounting periods.

So, if a company has three 51% group companies the URMA is £375,000. Any of the companies that have taxable profits exceeding that figure will be subject to the instalment payments regime. Those which do not exceed that figure will not be subject to the regime.

Some companies have many group companies and are treated as being large even though their own corporation

tax liability is relatively small. Where the corporation tax liability is less than £10,000 there is no requirement to pay by instalments.

Growing companies

A company does not have to pay its corporation tax by instalments in an accounting period if:

- its taxable profits for that accounting period do not exceed £10 million and
- it was not large for the previous year.

Where there are associated companies or 51% related group companies, the £10 million threshold is divided by one plus the number of associates or one plus the number of 51% related group companies at the end of the preceding accounting period. The threshold is also proportionately reduced for short accounting periods.

This gives companies time to prepare for paying by instalments (but see below).

The pattern of quarterly instalment payments

A large company with a 12 month accounting period will pay tax in four equal instalments, in months 7, 10, 13 and 16 following the start of the accounting period. The actual due date of payment is six months and 13 days after the start of the accounting period, then nine months and 13 days, and so on. So, for a company with a 12 month accounting period starting on 1 January, quarterly instalment payments are due on 14 July, 14 October, 14 January next and 14 April next.

There are special rules where an accounting period lasts less than 12 months.

Larger companies

Earlier dates will apply for the payment of corporation tax for larger companies and groups, for accounting periods starting on or after 1 April 2019. For companies with annual taxable profits of £20 million or more, tax will be payable in quarterly instalments in the third, sixth, ninth and twelfth months of their accounting period. For groups the £20 million threshold is divided by the number of companies in the group.

Pattern of payments for a growing company

If a growing company is defined as a large company for two consecutive years, the quarterly instalments payments regime will apply for the second of those years.

The transition from small to large is best illustrated by an example. A company with a 31 December year end was large in 2016 for the first time and is expected to be large in 2017. Its tax payments will be as follows:

- for the 2016 accounting period, the tax liability is payable on 1 October 2017.
- for the 2017 accounting period, 25% of its tax for 2017 in each of July and October 2017 and January and April 2018.

As can be seen, the first instalment for 2017 is payable before the tax liability for 2016. It is therefore essential that budgets are prepared of expected profits whenever a company becomes large in order to determine:

- whether the company will be large in the second year, and if so
- what tax payments will have to be made in month seven of the second year.

Working out quarterly instalment payments

A company has to estimate its current year tax liability (net of all reliefs and set offs) and then make instalment payments based on that estimate. This means that by month seven, a company has to estimate profits for the remaining part of the accounting period.

In particular note that tax due under the loans to participators legislation is also included.

A company's estimate of its tax liability will vary over time. The system of instalment payments allows a company to make top-up payments – at any time – if it realises that the instalment payments it has made are inadequate. A company will normally be able to have back all or part of any instalment payments already made if later it concludes that they ought not to have been made, or were excessive.

Interest and penalties

Interest is calculated only once a company has filed its tax return, or HMRC have made a determination of its corporation tax liability and the normal due date has passed.

The payments the company makes are compared to the amounts that ought to have been paid throughout the instalment period. If a company has paid too much for a period compared to the amount of corporation tax that was due to have been paid, it will be paid interest. If it has paid too little, it will be charged interest.

Rates of interest

Special rates of interest apply for the period from the due and payable date for the first instalment to the normal due and payable date for corporation tax (nine months and one day from the end of the accounting period). Thereafter, the interest rates change to the normal interest rates for under and

overpaid taxes. This two-tier system takes into account the fact that companies will be making their instalment payments based on estimated figures but, by the time of the normal due date, should be fairly certain about their liability.

Interest received by companies is chargeable to tax, and interest paid by companies is deductible for tax purposes.

Penalties

A penalty may be charged if a company deliberately fails to make instalment payments, or makes instalment payments of insufficient size.

Special arrangements for groups

There is a group payment arrangement facility which allows groups to make instalment payments on a group-wide basis, rather than company by company. This should help to minimise their exposure to interest.

How we can help

If you think your company may be affected by the quarterly instalment regime, procedures will need to be set in place to estimate the liability.

We will be more than happy to provide you with assistance or any additional information required so please do contact us.

HOMEWORKING COSTS FOR THE SELF-EMPLOYED

Over the last ten years technology has advanced massively. It was not so long ago that mobile phones were the size of a brick. Now emails and the internet can be accessed on the move. However, whilst technology has moved on, travelling has become more and more difficult. Homeworking has become the answer for many but how have the tax rules kept up with these changes?

Your status is important

The tax rules differ considerably depending on whether you are self-employed, as a sole trader or partner, or whether you are an employee, even if that is as an employee of your own company. One way or the other though, if you want to maximise the tax position, it is essential to keep good records. If not, HMRC may seek to rectify the tax position several years down the line. This can lead to unexpected bills including several years' worth of tax, interest and penalties.

This factsheet focuses on the position of the self-employed.

Wholly and exclusively

The self-employed pay tax on the profits that the business makes or their share of those profits. So, the critical issue is to ensure that costs incurred can be set against that profit. For day to day overheads, those costs generally have to be incurred 'wholly and exclusively' for the purposes of the trade to be tax deductible. What does this really mean in practice? Well, HMRC have issued a lot of guidance on the matter which is summarised below.

Use of the home

If the self-employed carry on some of their business from home, then some tax

relief may be available. HMRC accept that even if the business is carried on elsewhere, a deduction for part of the household expenses is still acceptable provided that there are times when part of the home is used solely for business purposes. To quote:

'If there is only minor use, for example writing up the business records at home, you may accept a reasonable estimate without detailed enquiry.'

So that there is no confusion, wholly and exclusively does not mean that business expenditure has to be separately billed or that part of the home must be permanently used for business purposes. However, it does mean that when part of the home is being used for the business then that is the sole use for that part at that time.

HMRC accept that costs can be apportioned but on what basis? Well, if a small amount is being claimed then HMRC will usually not be too interested. In fact, HMRC seem to accept that an estimate of a few pounds a week is acceptable. However, if more is to be claimed then HMRC suggest that the following factors are considered:

- the proportion in terms of area of the home that is used for business purposes
- how much is consumed where there is a metered or measurable supply such as electricity, gas or water and
- how long it is used for business purposes.

What sort of costs can I claim for?

Generally, HMRC will accept a reasonable proportion of costs such as council tax, mortgage interest, insurance, water rates, general repairs and rent, as well as cleaning, heat and light and metered water.

Other allowable costs may include the cost of business calls on the home telephone and a proportion of the line

rental, in addition to expenditure on internet connections to the extent that the connection is used for business purposes.

So how does this work in practice?

As already mentioned, if there is a small amount of work done at home, a nominal weekly figure is usually fine but for substantial claims a more scientific method may be needed.

Example

Andrew works from home and has no other business premises. He uses a spare room from 9am to 1pm and then from 2pm until 6pm. The rest of the time it is used by the family. The room represents about 10% of the total area of the house.

The costs including cleaning, insurance, council tax and mortgage interest are about £8,000. 10% = £800 and 8/24 of the use by time is for business, so the claim could be £267. Electricity costs total £1,500, so 10% is £150 of which 8/24 = £50.

In addition, a reasonable proportion of other costs such as telephone and broadband costs would be acceptable. The key to Andrew's claim will be that he keeps the records to prove the figures and proportions used.

Equipment costs

For self-employed businesses, the depreciation of assets is covered by a set of tax reliefs known as capital allowances. For equipment at home, such as a laptop, desk, chair, etc, capital allowances may be available on the business proportion (based on estimated business usage) of those assets. So, if Andrew uses his laptop solely for business, the whole cost will be within the capital allowances rules.

What about travel costs?

Another consequence of working from home is the potential impact on travel costs. The cost of travelling from home to the place of business or operations is generally disallowed, as it represents the personal choice of where to live. The fact that the individual may sometimes work at home is irrelevant.

Where an individual conducts office work for their trade does not by itself determine their place of business, so although many may be able to claim tax relief for the costs of working from home, far fewer will be able to claim travel costs of going to and from their home office.

Of course, this principle presupposes that there is a business or operational 'base' elsewhere from which the trade is run. Normally, the cost of travel between the business base and other places where work is carried on will be an allowable expense, while the cost of travel between the taxpayer's home and the business base will not be allowable. However, where there are no separate business premises away from the home, travel costs to visit clients should be fully allowable. The crux of the matter is where the business is really run from.

And finally

Capital gains tax contains a tax exemption for the sale of an individual's private home, known as principal private residence relief (PPR). Where part of the dwelling is used exclusively for business purposes, PPR relief will not apply to the business proportion of the gain. However, HMRC make clear in their guidance that 'occasional and very minor' business use is ignored.

Be reasonable

As you can see, all things are possible but the key is to be clear about the rules, keep good records and be sensible about how much to claim.

How we can help

If you would like any help about obtaining tax relief on the costs of homeworking or other expenses, please contact us.

CASH BASIS FOR THE SELF-EMPLOYED

We consider the optional rules which allow small unincorporated businesses to calculate their profits for tax purposes on a cash basis rather than the normal accruals basis.

Accruals basis and cash basis

One example which illustrates the difference between the accruals basis and cash basis is that credit sales are included in the accruals basis accounts income despite the fact that the customer may not have paid for the goods or services by the end of the accounting period. Under the optional cash basis the business is taxed on its cash receipts less allowable cash payments made during the accounting period. So under the optional cash basis credit sales are accounted for and taxed in the year in which they are paid for by the customer.

Cash basis eligibility

The main entry criteria are that your business is unincorporated (sole trader or a partnership consisting only of individuals) and that your receipts in the accounting period are less than the entry threshold. From 1 April 2017 the entry threshold is £150,000. The exit threshold is £300,000.

There are some individual exclusions from cash basis, for example, Limited Liability Partnerships, Lloyd's underwriters and those eligible individuals who wish to continue to claim averaging of profits like farmers. Once the cash basis election is made an individual will generally have to remain in the scheme unless the business either grows too large or there is another acceptable 'change of circumstances.' These matters are not considered further here.

Key tax points

Cash receipts

Cash receipts literally mean all cash receipts that the business receives during the accounting period. As well as trading income this will also include the proceeds from the sale of any plant and machinery. If a customer does not pay what is owed by the accounting year end then it will not be taxable until the next year when it is actually received by the business.

What deductions are allowable?

In terms of what deductions can be claimed the main rules are that the expenses must have been actually paid in the accounting period as well as being incurred wholly and exclusively for the purposes of the trade.

As is the case with calculating taxable profits generally for a business no deductions are allowed for items which are of a capital nature such as the purchase of property. However, under the cash basis the costs of most plant and machinery can be included as a deduction. One key exception is the purchase of cars.

Relief for interest payments

If you have a business loan or overdraft only interest, payments up to a maximum limit of £500 can be claimed. If, in the future, you have a larger loan and wish to claim more interest as a deduction then this could be treated as a change of circumstances and result in you then having your accounts prepared on the accruals basis.

Restrictions on the use of losses

If your business incurs a loss then under the cash basis this can only be carried forward and set against profits of the same business in future years. This is not as advantageous as the normal rules which will allow the loss to be carried

back or set off 'sideways' against other income.

In order to ensure that income is taxed and expenses are relieved 'once and once only' special calculations are needed on entering or leaving the cash basis.

How we can help

So, in summary, as you can see there is more to the cash basis than might be expected and we would be happy to review your circumstances to see if this would be suitable for you and your business. Please contact us if you would like any further information.

INCORPORATION

The issue of whether to run your business as a company or a sole trader or partnership is an important decision. In this factsheet, we summarise the relevant tax changes which apply and show the potential tax savings currently available from operating as a company.

Changes to the taxation of dividends

Significant changes to the taxation of dividends took place for dividends received from April 2016. Our calculations show that incorporation may still result in lower tax bills than remaining unincorporated but the tax savings are significantly reduced from prior years.

The rules for the taxation of dividends

From 6 April 2016:

- The 10% dividend tax credit was abolished with the result that the cash dividend received is the gross amount potentially subject to tax.
- The rates of tax on dividend income are 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.
- A new Dividend Tax Allowance removes the first £5,000 of dividends received in a tax year from taxation. The Dividend Tax Allowance is to be reduced to £2,000 from 6 April 2018.

Is trading as a limited company still be the best option?

If you trade as a limited company you may think that to trade as a sole trader or as a partnership may now be a better option. In our view there is still a benefit in tax terms for most individuals to continue to trade as a limited company as there is still an annual tax saving.

Will it be better to take a dividend rather than an increase in salary?

In our view there is still a benefit for a director-shareholder to take a dividend rather than a salary. The amount of the tax saved will be less than under the previous rules but is still beneficial.

Tax savings

The examples below give an indication of the 2016/17 tax savings that may be achievable for husband and wife who are currently in partnership.

Profits:	£30,000	£50,000	£100,000
Tax and NI payable:	£	£	£
As partners	2,933	8,732	24,532
As company	2,598	7,192	19,730
Potential saving	335	1,540	4,802

The extent of the savings is dependent on the precise circumstances of the couple's tax position and may be more or less than the above figures. The examples are computed on the basis that the couple:

- share profits equally
- have no other sources of income
- both partners take a salary of £8,060 from the company with the balance (after corporation tax) paid out as a dividend.

When might a company be considered?

A company can be used as a vehicle for:

- a profitable trade
- buy-to-let properties

Summary of relevant tax and national insurance rates 2017/18

Rate of corporation tax

Profits are taxed at 19%.

National Insurance

The rate of employees' NIC is 12%. In addition, a 2% charge applies to all earnings over the NIC upper earnings limit (£45,000 for 2017/18). The rate of NIC for the self-employed is 9%, and 2% on profits above £45,000 for 2017/18. All NI contributions can be avoided by incorporating, taking a small salary up to the threshold at which NI is payable and then taking the balance of post-tax profits as dividends.

Pension provision

As an employee/ director of the company, it should be possible for the company to make pension contributions (subject to limits) to a registered fund irrespective of the salary level, provided it is justifiable under the wholly and exclusively rule. For further details of the tax position of pension provision for individuals see the factsheet on Pensions - Tax Reliefs. Such contributions are deemed to be a private expense for sole traders or partners.

Other tax issues

In addition we consider other relevant factors including potential disadvantages. It is all too easy to focus exclusively on the potential annual tax savings available by operating as a company. However, other tax issues can be equally, and in some cases more significant and should not be underestimated.

Capital gains

Incorporating your existing business will involve transferring at least some of your assets (most significantly goodwill) from

your sole trade or partnership into your new company. The transfer of goodwill may create a significant capital gain although there is a mechanism for deferring the gain until any later sale of the company if the business is transferred in exchange for shares in the company.

Changes to relief for goodwill

Generally where goodwill was sold to the company for cash or debt on or after 3 December 2014, individuals are prevented from claiming Entrepreneurs' Relief (ER) and capital gains tax arises on the gain. The exceptions to this rule are that a claim to ER is allowed:

- for partners in a firm who do not hold or acquire any stake in the successor company
- where the individual claiming relief holds less than 5% of the shares and the voting power of the acquiring company
- where an individual holds 5% or more of the shares or voting power if the transfer of the business to the company is part of arrangements for the company to be sold to a new, independent owner.

Stamp Duty Land Tax (SDLT)

There may be SDLT charges to consider when assets are transferred to a company. Goodwill and debtors do not give rise to a charge, but land and buildings may do so.

Income tax

The precise effects of ceasing business in an unincorporated form, including 'overlap relief' need to be considered.

Capital allowances

Once again the position needs to be carefully considered.

Other advantages

There may be other non-tax advantages of incorporation and these are summarised below.

Limited liability

A company normally provides limited liability. If a shareholder's shares are fully paid he cannot normally be required to invest any more in the company.

However, banks often require personal guarantees from the directors for borrowings. The advantage of limited liability will generally apply in respect of liabilities to other creditors.

Legal continuity

A company will enjoy legal continuity as it is a legal entity in its own right, separate from its owners (the shareholders). It can own property, sue and be sued.

Transfer of ownership

Effective ownership of the business may be more readily transferred, in comparison to a business which is not trading as a limited company.

Borrowing

Normally a bank is able to take extra security by means of a 'floating charge' over the assets of the company and this will increase the extent to which monies may be borrowed against the assets of the business.

Credibility

The existence of corporate status is sometimes deemed to add to the credibility or commercial respectability of the business.

Pension schemes

The company could establish an approved pension scheme which may

provide greater benefits than self-employed schemes.

Staff incentives

Employees may, with adequate safeguards, be offered an opportunity to acquire an interest in the business, reflecting their position in the company.

Disadvantages

No analysis of the position would be complete without highlighting potential disadvantages.

Administration

The annual compliance requirements for a company in terms of administration and accounting tend to result in costs being higher for a company than for a sole trader or partnership. Annual accounts need to be prepared in a format dictated by the Companies Act and, in certain circumstances, the accounts need to be audited by a registered auditor.

Details of the directors and shareholders are filed on the public register held by the Registrar of Companies.

Privacy

The annual accounts have to be made available on public record - although these can be modified to minimise the information disclosed.

PAYE/Benefits

If you do not have any employees at present, you do not have to be concerned with PAYE and returns of benefits forms (P11Ds). As a company, you will need to complete PAYE records for salary payments and submit details of salary payments on a timely basis under PAYE Real Time Information. You will also need to keep records of expenses reimbursed to you by the company. Forms P11D may have to be completed.

Dividends

If you will require regular payments from your company, we will need to set up a system for you to correctly pay dividends.

Transactions with the business owner

A business owner may introduce funds to and withdraw funds from an unincorporated business without tax implications. When a company is involved there may be tax implications on these transactions.

Director's responsibilities

A company director may be at risk of criminal or civil penalty proceedings eg for late filing of accounts or for breaking the insolvency rules.

How we can help

There may be a number of good reasons for considering use of a company as part of a tax planning strategy. However as you can see from this factsheet, there are many factors to consider and proposed changes to the tax law may change this advice for some individuals. We would welcome the opportunity to talk to you about your own specific circumstances. Please do not hesitate to contact us.

IR35 PERSONAL SERVICE COMPANIES

The 'IR35' rules are designed to prevent the avoidance of tax and national insurance contributions (NICs) through the use of personal service companies and partnerships.

The rules do not stop individuals selling their services through either their own personal companies or a partnership. However, they do seek to remove any possible tax advantages from doing so.

Summary of approach

Removal of tax advantages

The tax advantages mainly arise by extracting the net taxable profits of the company by way of dividend. This avoids any national insurance contributions (NICs) which would generally have been due if that profit had been extracted by way of remuneration or bonus.

The intention of the rules is to tax most of the income of the company as if it were salary of the person doing the work.

To whom does it apply?

The rules apply if, had the individual sold his/her services directly rather than through a company (or partnership), he/she would have been classed (by HMRC) as employed rather than self-employed.

For example, an individual operating through a personal service company but with only one customer for whom he/she effectively works full-time is likely to be caught by the rules. On the other hand, an individual providing similar services to many customers is far less likely to be affected.

Planning consequences

The main points to consider if you are caught by the legislation are:

- the broad effect of the legislation will be to charge the income of the

company to NICs and income tax, at personal tax rates rather than corporate tax rates

- there may be little difference to your net income whether you operate as a company or as an individual
- to the extent you have a choice in the matter, do you want to continue to operate through a company?
- if the client requires you to continue as a limited company, can you negotiate with the client for increased fees?
- if you continue as a limited company you need to look at the future company income and expenses to ensure that you will not suffer more taxation than you need to.

The last point is considered in more detail below.

Employment v self-employment

One of the major issues under the rules is to establish whether particular relationships or contracts are caught. This is because the dividing line between employment and self-employment has always been a fine one.

All of the factors will be considered, but overall it is the intention and reality of the relationship that matters.

The table below sets out the factors which are relevant to the decision.

HMRC will consider the following to decide whether a contract is caught under the rules

Mutuality of obligation	the customer will offer work and the worker accept it as an ongoing understanding?
Control	the customer has

	control over tasks undertaken/hours worked etc?
Equipment	the customer provides all of the necessary equipment?
Substitution	the individual can do the job himself or send a substitute?
Financial risk	the company (or partnership) bears financial risk?
Basis of payment	the company (or partnership) is paid a fixed sum for a particular job?
Benefits	the individual is entitled to sick pay, holiday pay, expenses etc?
Intention	the customer and the worker have agreed there is no intention of an employment relationship?
Personal factors	the individual works for a number of different customers and the company (or partnership) obtains new work in a business-like way?

Exceptions to the rules

If a company has employees who have 5% or less of the shares in their employer company, the rules will not be applied to the income that those employees generate for the company. Note however that in establishing whether the 5% test is met, any shares held by 'associates' must be included.

How the rules operate

The company operates PAYE & NICs on actual payments of salary to the individual during the year in the normal way.

If, at the end of the tax year - ie 5 April, the individual's salary from the company, including benefits in kind, amounts to less than the company's income from all of the contracts to which the rules apply, then the difference (net of allowable expenses) is deemed to have been paid to the individual as salary on 5 April and PAYE/NICs are due.

Allowable expenses:

- normal employment expenses (eg travel)
- certain capital allowances
- employer pension contributions
- employers' NICs - both actually paid and due on any deemed salary
- 5% of the gross income to cover all other expenses.

Where salary is deemed in this way:

- appropriate deductions are allowed in arriving at corporation tax profits and
- no further tax/NICs are due if the individual subsequently withdraws the money from the company in a HMRC approved manner (see below).

Points to consider from the working of the rules

Income and expenses

The income included in the computation of the deemed payment on 5 April includes the actual receipts for the tax year.

The expenses are those incurred by the company between these two dates. In order to perform the calculations, you need to have accurate information for the company's income and expenses for this period. You may need to keep separate records of the company

expenses which will qualify as 'employee expenses'.

Timing of corporation tax deduction for deemed payment

A deduction is given for the deemed payment against profits chargeable to corporation tax as if an expense was incurred on 5 April. This means that relief is given sooner where the accounting date is 5 April.

Pension contributions

Payments made by your company into a personal pension plan will reduce the deemed payment. This can be attractive as the employer's NICs will be saved in addition to PAYE and employee's NICs.

Other points to consider

Extracting funds from the company

For income earned from contracts which are likely to be caught by the rules, the choices available to extract funds for living expenses include:

- paying a salary
- borrowing from the company and repaying the loan out of salary as 5 April approaches
- paying interim dividends.

The advantage of paying a salary is that the tax payments are spread throughout the year and not left as a large lump sum to pay on 19 April (22 for cleared electronic payment). The disadvantage is fairly obvious!

Borrowing from the company on a temporary basis may mean that no tax is paid when the loan is taken out, but it will result in tax and NICs on the notional interest on the loan. There may also be a need to make a payment to HMRC equal to 25% (32.5% for loans made on or after 6 April 2016) of the loan under the 'loans to participators' rules.

The payment of dividends may be the most attractive route. If a deemed payment is treated as made in a tax year, but the company has already paid the same amount to you or another shareholder during the year as a dividend, you will be allowed to make a claim for the tax on the dividend to be relieved to avoid double taxation. The company must submit a claim identifying the dividends which are to be relieved.

Example of payment of dividend

Mr Arthur owns 100% of the share capital of Arthur Ltd. All the income of the company is caught by the IR35 rules. Accounts are prepared to 5 April 2017. An interim dividend of £20,000 is paid on 30 September 2016. The deemed payment on 5 April 2017 is £80,000. There is no immediate tax cost of the dividends being paid out either to the company or to the shareholder. The company will pay tax and NICs on the deemed payment of £80,000 in the normal way ie on 19 April 2017. The company can make a claim for the £20,000 dividend not to be treated as a dividend for tax purposes in Mr Arthur's hands.

Getting ready for 5 April

There is a tight deadline for the calculation of the deemed payment and paying HMRC. The key dates are:

- the deemed payment is treated as if an actual payment had been made by the company on 5 April
- tax and NICs have to be paid to HMRC by 19 April
- final RTI submissions showing details of the deemed payment has to be submitted to HMRC by 19 April.
- Where a provisional payment of tax and National Insurance contributions has been made

because it has not been possible to accurately calculate the deemed payment and deductions by 19 April, then any adjustments should be reported via an Earlier Year Update (EYU) submitted electronically to HMRC before the following 31 January. However, interest on overdue tax is chargeable from 19 April if tax and NICs are underpaid on the basis of provisional figures.

It is therefore in your interests to have accurate information on the company's income and expenses on a tax year basis and, in particular, separate records of the amount of the company expenses which will qualify as 'employee expenses'.

Partnerships

Where individuals sell their services through a partnership, the rules are applied to any income arising which would have been taxed as employment income if the partnership had not existed.

In other words, where a partnership receives payment under an 'employment contract':

- income of the partnership from all such contracts in the year (net of allowable expenses as described above) are deemed to have been paid to the individuals on 5 April as salary from a deemed employment with PAYE/NICs due accordingly and
- any amount taxed in this way as if it were employment income is not then taxed as part of the partnership profits.

Partnerships excluded from the rules

Many partnerships are not caught by the rules even if one or more of the partners performs work for a client which may

have the qualities of an employment contract.

The rules will only apply to partnerships where:

- an individual, (either alone or with one or more relatives), is entitled to 60% or more of the profits or
- all or most of the partnership's income comes from 'employment contracts' with a single customer or
- any of the partners' profit share is based on the amount of income from 'employment contracts'.

Penalties

Where a personal service company or partnership fails to deduct and account for PAYE/NICs due under the rules, the normal penalty provisions apply.

If the company or partnership fails to pay, it will be possible for the tax and NICs due to be collected from the individual as happens in certain circumstances under existing PAYE and NIC legislation.

Intermediaries - travel and subsistence

From 6 April 2016, changes to the rules are introduced to restrict tax relief for travel and subsistence expenses for workers engaged through an employment intermediary, such as a recruitment agency or a personal service company.

No relief will be allowed for home to work travel and subsistence where a worker:

- personally provides services to another person
- is employed through an employment intermediary
- is under (the right of) the supervision, direction or control of

any person, in the manner in which they undertake their work.

Employment intermediary will be defined as a person, other than the worker or the client, who carries on a business (whether or not with a view to profit and whether or not in conjunction with any other business) of supplying labour.

Where a personal service company is also within the scope of the IR35 legislation this measure will only apply to those contracts where a deemed employment payment is made, or would be made if all the individual's remuneration was not being taken as employment income. In these circumstances the supervision, direction or control test will not be used.

Managed Service Companies (MSCs)

MSCs had attempted to avoid the IR35 rules. The types of MSCs vary but are often referred to as 'composite companies' or 'managed PSCs'. HMRC had encountered increasing difficulty in applying the IR35 rules to MSCs because of the large number of workers involved and the labour-intensive nature of the work. Even when the IR35 rules had been successfully applied, an MSC often escaped payment of outstanding tax and NIC as they have no assets and could be wound up.

The government has introduced legislation which applies to MSCs. The rules:

- ensure that those working in MSCs pay PAYE and NIC at the same level as other employees
- alter the travel and subsistence rules for workers of MSCs to ensure they are consistent with those for other employees
- allow the recovery of outstanding PAYE and NIC from 'specified persons', primarily the MSC

directors, if the amounts cannot be recovered from the company.

MSCs are required to account for PAYE on all payments received by individuals.

Off-payroll working in the public sector

Changes are being made to the IR35 rules in relation to engagements in the public sector. These changes will:

- move the decision of whether to apply the IR35 rules from the individual worker's own service company to the public sector body, agency or third party paying them
- the public sector engager or agency will be treated as an employer for the purposes of tax and Class 1 NICs (including employer NICs) and the amount paid to the worker's intermediary will be deemed to be a payment of employment income to that worker
- the 5% allowance used by the worker's intermediary for certain business expenses will be removed for those contracts with the public sector.

HMRC have provided a new digital tool to help identify whether engagements fall within the new rules, which will apply to contracts entered into, or payments made, on or after 6 April 2017.

How we can help

We can advise as to the best course of action in your own particular circumstances. If IR35 does apply to you we can help with the necessary record keeping and calculations so please do contact us.

RESEARCH AND DEVELOPMENT

Research and development (R&D) by UK companies is being actively encouraged by Government through a range of tax incentives. The government views investment in research and development ('R&D') as a key to economic success. It is therefore committed to encouraging more smaller and medium sized ('SME') companies to claim R&D tax relief. The incentives are only available to companies and include:

- increased deduction for R&D revenue spending and
- a payable R&D tax credit for companies not in profit.

The government is committed to improving access to R&D highlights the need for more SME companies to understand what relief is available and how the process of claiming tax relief works. Recent changes to R&D scheme rates have increased the relief available so a clear understanding is needed to ensure that companies are aware of how the tax rules work.

In the Autumn Statement 2016 the Chancellor highlighted that research and development is a key driver for economic growth and has committed to an extra £2 billion a year of additional funding by 2020/21. The government will also review ways to build on the 'above the line' tax credit which is covered in the section on Research and Development Expenditure Credit scheme below.

What are the tax reliefs available for SME companies?

A company can claim enhanced deductions against its taxable profits for expenditure which is qualifying R&D expenditure. The amount of the enhancement has increased over the years. The rate was 125% for expenditure incurred before 31 March 2015 and has increased to 130% from 1 April 2015. This amount is in addition to

the actual expenditure (ie a 230% total deduction from 1 April 2015). R&D enhanced relief represents an additional corporation tax reduction of 26% of the expenditure incurred.

If the R&D claim creates a tax loss, then the company may be able to surrender the loss for a cash repayment. This is 14.5% for expenditure incurred on or after April 2014. A surrendered loss could therefore give a repayment of up to 33.35% of the expenditure.

Where the company incurs qualifying R&D expenditure before it starts to trade, it can elect to treat 230% of that expenditure as a trading loss for that pre-trading period. The pre-trading loss created by the R&D relief can then be surrendered, as above, which could provide much needed cash flow for new companies.

Qualifying R&D capital expenditure incurred by a company would be eligible for 100% research and development allowance. Details of this allowance are not provided in this summary.

Example of R&D claim

A company has adjusted net profits of £50,000 before an R&D claim and allowable R&D expenditure of £70,000. The enhanced claim is therefore $£70,000 \times 130\% = £91,000$. Deducting this from the adjusted profits gives a loss of £41,000. The company decides to surrender this loss for a cash repayment. The amount they would receive is $£41,000 \times 14.5\% = £5,945$.

Research and Development Expenditure Credit scheme (RDEC)

R&D relief under the SME scheme is not available if the R&D project has had the benefit of a grant or subsidy. There may, however, be an alternative claim available to the company. This is known as the Research and Development Expenditure Credit scheme (RDEC). RDEC

allows the SME to claim a taxable credit of 11% of eligible expenditure. As this amount is taxable it is known as an 'above the line' credit. This 11% rate is for expenditure incurred on or after 1 April 2015. Prior to that date the rate was 10%.

The credit received is used to settle corporation tax liabilities of the current, future or prior periods subject to certain limitations and calculations. Where there is no corporation tax due the amount can be used to settle other tax debts or can be repaid net of tax.

The RDEC relief is also available to an SME for expenditure incurred on R&D that is contracted to it by a large company.

Qualifying projects

R&D relief can only be claimed by companies that have incurred expenditure on qualifying R&D projects that are relevant to the company's trade. A project should address an area of scientific or technological uncertainty and be innovative. The innovation needs to be an improvement in the overall knowledge in the relevant field of research, not just an advancement for the company. Qualifying projects could include those which:

- increase the life of a battery
- create a new type of material in an item of clothing
- develop new spark plugs for use in an existing engine.

An important point to appreciate is that the activity does not have to create something completely new from scratch. It could include:

- developing a product that exists but where there is some technological uncertainty which can be improved
- making an improvement to a product or process eg exploring new

cost effective materials which will allow a product to perform better.

Companies should document the uncertainties and planned innovation at the start of a project to provide evidence to support an R&D claim.

Relevant activities on R&D

Once the company is comfortable that R&D is taking place, then the next step is to identify the activities of the business that relate to the R&D activity.

There are essentially two types of activities:

- those that contribute directly to achieving the advancement
- certain activities that indirectly contribute to achieving the advancement.

Examples of direct activities are:

- scientific or technological planning
- scientific or technological design, testing, and analysis
- activities which design or adapt software, materials or equipment.

Examples of indirect activities are:

- information services eg preparation of R&D reports
- indirect supporting services eg maintenance, security, clerical
- ancillary services eg paying staff, leasing laboratories and equipment.
- Indirect activities would all have to be undertaken for the R&D project.

Once the project begins to be involved in the production process, any R&D activities are treated as having stopped as development has finished. It is therefore beneficial for companies to keep a timeline of activities and their purposes to detail when the business

starts to move into the production phase and therefore optimise their claims.

Types of expenditure

Qualifying expenditure which is incurred on activities which are either directly or indirectly related to the R&D project fall into different categories. These are as follows:

- staffing costs
- software
- expenditure on consumable or transformable materials
- costs of work done by subcontractors and externally provided workers
- costs of clinical trial volunteers.

To be eligible, expenditure must be revenue in nature and paid by the time that the R&D claim is accepted. This means any accruals for expenditure have to be monitored carefully after the year end to make sure that they are paid and not written back to profit.

Further detail on some of these categories is provided below.

Staffing costs

The staff costs include employees and director staff costs ie salaries, employer pension contributions, employers' NIC but not non-cash benefits-in-kind. Where an employee or director only spends part of their time on an R&D project then the costs are apportioned. The relevant staff are those involved in the directly and indirectly related activities highlighted above.

The indirect activity list included categories for 'supporting' and 'ancillary' services. The staff who perform these services should be providing supporting or ancillary services for the R&D project and not for the other people who are directly involved in the R&D project.

Examples

- The salary costs of a maintenance worker working full time on maintaining laboratory equipment used for R&D can be claimed.
- The salary costs of an accountant keeping a record of the maintenance work done including the laboratory maintenance cannot be claimed.

If directors are taking dividends from the company rather than salaries it may be more beneficial to change this for any directors involved in R&D.

Consumable transformable materials

Materials that are consumed or transformed in the R&D activity are eligible expenditure. Items included would have to be items which were consumed or transformed so that they were no longer usable in their original form. This would therefore include:

- water
- power
- fuel
- a chemical substance which is transformed
- an electrical component.

For expenditure on or after 1 April 2015, any consumables or transformable materials that are included in a product that is sold, transferred or hired out will not be qualifying expenditure for R&D relief.

Costs of work subcontracted out and externally provided workers

Where the SME subcontracts qualifying R&D work to a subcontractor, the SME can claim a deduction for the cost of the subcontractor work. The amount that

can be claimed depends on whether the SME is connected to the subcontractor but generally it is 65% of qualifying costs. Similar rules apply to externally provided workers.

Methods of claiming tax relief

Companies can claim R&D tax relief in the tax return for the period when the expenditure is charged in the accounts of the company. HMRC have specialist offices which are able to offer advice on R&D claims.

Helping smaller companies

Following consultation, the government introduced in November 2015 a voluntary Advanced Assurance scheme for small businesses making their first claim. Successful applicants will receive assurance that HMRC will allow their first three years of R&D tax relief claims without further enquiry.

In addition, there will be new bespoke guidance aimed at smaller companies and more direct communication between HMRC and companies that are already claiming, or thinking about claiming, R&D tax relief.

How we can help

There are a number of areas in this briefing where you may need specific advice depending on the circumstances of R&D activities and expenditure so please do not hesitate to contact us.

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