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Newsletter

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Is the cash basis right for you?

HMRC plans to expand the availability of cash basis accounts preparation, but will it win over businesses from the traditional accruals basis?

The cash basis can currently only be used if a business's annual turnover doesn't exceed £150,000, so one option from HMRC is to increase this turnover limit to £1.35 million. But will this increase uptake?

Why opt for cash basis accounting?

For some businesses, the cash basis is helpful as it stands, because there is no need to take account of debtors, prepayments, creditors and stock. It also allows most equipment purchases to be simply deducted as an expense.

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But there are two significant restrictions:

- Currently, there is a £500 cap on interest costs. When interest rates are higher, this cap is not beneficial. Although HMRC is looking at increasing the limit – possibly to as high as £1,000 – the cap could remain a deterrent for some.
- Losses can only be carried forward – they cannot be relieved against other income or carried back. HMRC is considering relaxing these rules, but relief is unlikely to be as generous as when traditional accruals basis accounting rules are applied.

New businesses, in particular, may have higher borrowings and be more likely to make a loss.

There is also less scope for tax planning. Using the traditional method, a capital allowance claim, for example, can be restricted to maximise use of the personal allowance. Not so with the simplified cash basis.

The accruals basis alternative

Beyond tax, there are several other reasons for preferring accruals basis accounting. Cash accounting is less precise in matching revenues earned with money laid out for expenses, resulting in a less accurate picture of a business's performance. Such simplified accounts might turn out to be inadequate when it comes to applying for a business loan or a personal mortgage, for instance.

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TAX

Making the dividend or bonus decision

The end of the tax year is drawing near and many owner-directors of companies will turn their minds to deciding which is more tax-efficient: a bonus or a dividend.

Tax laws and rates that will affect your decision have changed since 2022:

- The dividend allowance has been halved, from £2,000 to £1,000 (with a similar cut to the capital gains tax annual exempt amount).
- The additional rate (top rate in Scotland) tax threshold has fallen from £150,000 to £125,140.
- Corporation tax rates have increased for companies with profits of more than £50,000 a year.
- National insurance contribution rates have been reduced for directors and employers.
- The pensions annual allowance has increased to £60,000 and the abolition of the pensions lifetime allowance is being phased in.

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All these changes, which interact with each other, mean that the most tax-efficient way to draw profits from a company is likely to differ in 2023 from 2022.

Pension contributions?

An employer pension contribution could be a more attractive option for dealing with profits in 2023 than in 2022. For some, a pension contribution may not have made sense in 2022, because the lifetime allowance rules were still in force. These essentially limited the amount you could hold in your pension scheme. If those rules prevented you and/or your company from making pension contributions in recent years, this financial year end could be the ideal time to catch up.

There is no lifetime allowance charge in 2023/24 and the lifetime allowance is abolished entirely from 6 April 2024, meaning that you, or your company, can add as much as you like to your pension scheme. While they have to be justified, employer pension contributions can be significant, and would benefit from full corporation tax relief at the new, higher rates.

In practice, the complexities of pensions alongside other tax changes mean it is vital to seek advice before taking any action.

TAX

Inheritance tax penalties soar

The value of inheritance tax (IHT) penalties to government receipts has increased by more than half over the past two years, with higher property values and the frozen IHT nil rate band pushing more estates into the IHT net.

Credit: Ground Picture/Shutterstock.com

Last year, 4% of estates had to pay IHT, with an average tax bill of over £210,000. The most common reasons for HMRC charging a penalty are because:

- Forms are not filed on time or IHT is paid late. (The deadline is six months after the month of the death).
- Assets are undervalued or even omitted entirely. Valuing property of an unusual nature can be difficult, so it's wise to obtain a formal valuation from a qualified surveyor.
- Lifetime gifts, made by the deceased in the seven years before death, are overlooked. It can be difficult enough trying to establish cash gifts from bank statements, and there may be no record at all where gifts of assets, such as jewellery or antiques, have been made.

The seven-year look back requirement can be particularly confusing. More confusing still is where the deceased 'gifted' an asset, such as their main residence, to children, but then continued to live in it. Regardless of when the 'gift' was made, the property is still part of the deceased's estate.

Penalties for underpayment

The amount of penalty will depend on the circumstances leading to the IHT underpayment:

- Reasonable care has been taken – up to 30% penalty (but be warned that this let-out will not apply if a professional valuation hasn't been obtained for a property or other valuable assets).
- Assets have been deliberately omitted from an IHT return – up to 70% penalty.
- Hiding a deliberate error – up to 100%.

TAX

Accounts filing

Private companies and limited liability partnerships (LLPs) have nine months from the end of their accounting period to submit accounts to Companies House. The deadline is therefore fast approaching for those with 31 March year ends.

A late filing penalty can be as much as £1,500, even if a company is inactive:

Lateness	Penalty
Up to 1 month	£150
1 to 3 months	£375
3 to 6 months	£750
Over 6 months	£1,500

The penalty is doubled if accounts are submitted late two years in a row.

Given the holiday closures in December, don't leave accounts submission to the last moment. This is particularly the case for LLPs who cannot file online. Also, you should allow more time if filing online for the first time.

In extreme circumstances – such as company records being destroyed in a fire – you can apply for a filing extension. This avoids a penalty but must be applied for before the original deadline.

TAX

Savings income and the rise in higher rate taxpayers

Credit: Brian A Jackson / Shutterstock.com

Bank of England base rate increases, coupled with higher savings rates and frozen tax thresholds, are seeing more people pushed into the higher rate taxpayer category, or paying more tax on savings income. Tax-efficient investments could mitigate this burden.

National Savings & Investments (NS&I) is currently offering a one-year savings bond with a table-topping fixed rate of 6.2% – the highest on offer since this product's launch in 2009. A higher rate taxpayer will use up their £500 savings allowance with just over £8,000 invested in this bond. With £25,000 invested, there will be more than £1,000 of taxable savings income. However, it wasn't that long ago that a higher rate taxpayer could have had £100,000 invested before facing tax.

No surprise, then, that the number of taxpayers paying tax on savings income for 2023/24 is expected to be a million more than last year. Over 2.7 million taxpayers are estimated to have to pay tax on their savings income in this tax year, including nearly 1.4 million basic rate taxpayers, even though they have a higher (£1,000) savings allowance.

Dealing with change

The sudden increase in savings income is likely to catch many savers out. HMRC will collect tax either by:

- Adjusting an employee's PAYE tax code after receiving the customer's details from the relevant financial Institution – after the tax year has ended..
- Self-assessment payments after a taxpayer submits their tax return.

In both cases, taxpayers should keep careful track of the savings income they receive, especially if accounts are regularly opened and closed. Tax codes are notoriously inaccurate, so adjustments for savings income should always be checked.

Minimising tax where you can

Once taxpayers realise the tax implications of higher interest rates, they will want to minimise any future liabilities. Here are a few suggestions:

- Make the best use of ISA accounts.
- Consider moving funds into tax-free premium bonds. Although interest is not paid as such, those with larger investments (£10,000 plus) can expect regular winnings.
- Move savings into joint names if a partner is not maximising their savings allowance.
- Putting funds into longer-term accounts where interest will end up being taxed at the future (lower) tax rate, if your marginal tax rate is due to fall in a year or two's time.

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Higher tax rate

Just as savers are being caught out with increased interest rates, more taxpayers are being inadvertently brought into the higher rate tax net because of frozen tax thresholds. HMRC statistics show the number of higher rate taxpayers for 2023/24 growing over 40% since 2020/21.

While taxpayers will want to minimise their liability, one problem is that many simply do not have any spare funds to lock away in tax planning measures.

For those not so constrained:

- Pension saving becomes more attractive where each £100 invested effectively only costs £60.
- Life assurance-based bonds could be useful – these permit an annual 5% tax-deferred amount to be withdrawn with no tax consequences until maturity.

Employees might also want to consider a salary sacrifice arrangement involving a tax-efficient car or pension contributions to ease the income tax burden.

EMPLOYMENT

Flexible working – employment update

Employers need to be aware of changes to the flexible working regime expected in summer 2024. But proposals to give employees more flexibility for paternity leave are further away.

Flexible working

The big, expected change – the right to request flexible working from day one – is not included in the Flexible Working Act, which recently received Royal Assent. However, it seems as if the Government still intends to make this change. The Act includes the following changes:

- Employees will be able to make two flexible working requests in a 12-month period (currently only one such request can be made).
- Employers will have to consult with an employee before rejecting their request. A formal meeting will be required, with no blanket ban on flexible working requests, and a reason will have to be given if a request is rejected.
- Employers will have to respond within two months, rather than the current three.

Flexible working doesn't only mean working from home. An employee might, for example, wish to match working hours with their child's school terms.

Paternity leave

The paternity leave regime currently means an employee can take two weeks of leave in the first 56 days after birth or adoption. Should the changes come into force, employees will be able to take two separate one-week blocks at any point during the first year.

BUSINESS

Tax-deductible car charges

The expansion of London's Ultra Low Emission Zone (ULEZ) has focused attention on the business use of cars and whether clean air charges are tax-deductible.

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As well as London, ULEZ charges for non-compliant cars are imposed in Bristol and Birmingham, and there are clean air zones with differing rules in a few other cities in England and Scotland.

For self-employed people, a ULEZ charge is tax-deductible provided the cost has been incurred wholly and exclusively for business purposes. That does not include home to work travel unless the business is run from home, or home is the principal or only workplace.

Employees can receive tax-free reimbursement of ULEZ charges where incurred wholly, exclusively and necessarily in the performance of their employment.

Most company cars will be ULEZ compliant as it is only older cars that do not meet the standards (pre-2005 for petrol and pre-2015 for diesel). But where companies are looking to replace cars, it is worth considering going electric, as there are some useful tax incentives.

- The company car tax rate for fully electric cars is 2%, rising gradually to 5% in 2027/28. This is far lower than for petrol and diesel cars. For hybrids the rate depends on the electric range, but there is still a significant saving.
- There can be no fuel benefit because HMRC does not class electricity as a fuel.
- Paying for a charging point to be installed at an employee's home does not give rise to a taxable benefit if the employee has a company car.
- The advisory fuel rate for fully electric company cars has been increased to 10p per business mile. Where an employee uses their own electric car for business, the mileage rates (45p for the first 10,000 miles, then 25p) are the same as for other cars.
- For businesses, electric vehicles qualify for a 100% first-year allowance, as does the installation of a charging point.

TAX

Taxing influencers

Social media platforms such as Facebook, YouTube and Instagram have permeated most people's lives. With them has come a multitude of 'influencers', who can attract a large following and earn a living influencing people's buying choices. Many influencers might never have thought about whether their earnings are taxable.

Unsurprisingly, many businesses have recognised the potential of harnessing popular online personalities to promote their products or services and will pay them to do so. Payment may be in the form of free goods, but those influencers with big audiences and perceived credibility can earn large amounts of money.

Credit: G-Stock Studio/ Shutterstock.com

This has not gone unnoticed by HMRC. In January 2023, using information from online platforms, HMRC started sending 'nudge' letters to people who they believe are earning at least £12,570 (the personal allowance) from their online content. Generating income from creating online content is likely to have the characteristics of trading under principles established in a long line of decisions by the courts.

Types of income

Income may arise in various forms. An influencer might post content on a number of sites and income is likely to depend on the number of views the content receives or from third-party advertisements placed alongside the content. Where a person is paid by a business to create social media content promoting its products, the influencer might even be taxable as an employee, depending on the contract terms. More often the influencer will be treated as self-employed.

Individuals whose social media activities only generate up to £1,000 a year need not worry because this is covered by the tax-free trading allowance. Those who earn more need to register with HMRC as self-employed and complete annual tax returns. Influencers may be able to deduct expenses incurred in generating their income, or simply deduct the £1,000 trading allowance. Seeking guidance is advisable.

NEWS IN BRIEF

News round up

HMRC interest rates

With a 7.75% late payment rate, it might be preferable to repay expensive credit card debt over making prompt tax payments. However, you must agree this in advance with HMRC. Conversely, the repayment rate is now a quite attractive tax-free 4.25%.

Advisory fuel rates

Employers who reimburse employees for business travel in their company cars need to be aware of mileage rate increases from 1 September. The three 1p, and one 2p, per mile increases apply to those company cars with higher capacity engines.

National Living Wage to rise

Ahead of his upcoming Autumn Statement, Chancellor Jeremy Hunt disclosed plans to raise the national living wage to a minimum of £11 per hour starting in April 2024. This proposal would result in a pay increase for workers aged 23 and above, lifting the current rate of £10.42.

Child benefit re-registration

Parents need to re-register for child benefit following a child's 16th birthday. This should have been done by 31 August, so if you missed this deadline, inform HMRC as soon as possible if your child is going to continue in approved education or training.

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