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Special Report …

"How To Pay Less Tax, Avoid & Deal With Tax Investigations – The Complete Guide For All Small Businesses"

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Contents

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Section 1

"How To Pay Less Tax, Avoid & Deal With Tax Investigations – The Complete Guide For All Small Businesses"

Attitude towards tax planning is what matters – read this even if you read nothing else

Hello

And welcome to **Tax Planning For Your Small Business.** This Special Report on "What Every Small Business Ought to Know About How To Pay Less Tax And Avoid Tax Investigations" is more than just an introduction to tax planning. It gives you lots of ideas you can start **implementing almost immediately** after speaking to your accountant.

It is specifically tailored to small businesses and individuals. Unless mentioned otherwise, every strategy suggested has been used successfully in practice by many small businesses time and time again. Some ideas have to be updated or even removed as legislation changes but at the time of writing, they are 100% **proven** methods that work today.

Why This Report Has Been Created For You

- ☐This report **focuses on small businesses**, identifies the key tax saving areas for them and uses jargon free language to explain them.

- ☐By reading the report, it will help you **get inside the head of your accountant** to put you in a position to know if your accountant is doing everything possible for you. You won't become a tax expert but it will enable you to have a sensible conversation with your accountant regarding what he or she should be looking at in your own situation.

- The ideas in this report don't go into every last detail of each idea. What it's trying to do is **help you to see** to a lot of what you could be doing. The further detail may mean they are not applicable to you after checking them out with your accountant in your situation, but they will work in the majority of cases. Sometimes matters are simplified to help you understand the point. It's a report for clients, not accountants.

- This isn't a report about what forms you have to fill in, what the deadlines are, etc. That's all the **boring compliance stuff that accountants look after.** This is the **proactive** stuff that makes a real difference that you also want your accountant to be doing for you. This is the stuff that will pay for their fees many times over.

If You Can't Be Bothered To Read This Report

It's recommended that you do. However, if you just want someone to do it all for you, you need to choose the right accountant. If you want the type of advice contained in this report please call us.

The Ideas That Are Best For Small Businesses

The type of tax planning ideas ideal for small businesses are:

1. **LOW COST** in relation to the tax savings obtained. Small businesses don't have never ending budgets for accountancy fees and all solutions have to be cost effective for you**.**

2. **QUICK & EASY**– you are busy with your business and don't have ages to spend on implementing tax ideas. So they must allow you to do them relatively quickly. Having the right accountant who is experienced and who can show you exactly what to do and provide you with any standard documentation makes this a lot easier.

3. **LEGAL** – you don't want to get into trouble with the Taxman as this could lead to an **investigation** that can cost you thousands in accountants' fees, as well as a lot of time and stress.

If your business grows substantially, there will be other options we can offer you in terms of tax planning but these are more complex and beyond the scope of this report.

All the ideas in this report are legal and apart from one or two that were just too good to leave out, they all follow the above principles. They are the key areas faced by many small businesses. However, as tax is such a vast subject area there will always be one or two more ideas applicable in your own particular circumstances and it is worth arranging a FREE consultation with us in this regard. Tax planning is unlimited if you put your mind to it.

This Report assumes your tax knowledge is either non-existent or limited.

But My Existing Accountant Looks After All That Tax Stuff For Me

They may do, but consider the following…

- ☐ **How do you know** they are doing everything possible for you to reduce your tax bills and avoid the chance of having a tax investigation? This report will help you find out.

- ☐ **Not all accountants are the same**. Of course, partly thanks to Monty Python there is the stereotype of the accountant being that "appallingly dull fellow, unimaginative, timid, spineless, easily dominated, no sense of humour, tedious company and irrepressibly drab and awful". But not all accountants are like this!

- ☐ **Have you asked** your accountant to save you tax? May be they just prepare your accounts and tax return, a tax compliance job rather than tax planning.

- ☐ Because your accountant is qualified, doesn't mean he or she automatically has a high level of tax planning skills. **Every accountant has skills in different areas** and you need to find one suitable to you.

- ☐ Different accountants have different attitudes to tax planning and it's **attitude** that counts for so much.

- ☐ **Are you sure** if your accountant is doing a good job for you or not with saving tax. This report will help you to decide and then you can make an informed decision to do something about it. This report will allow you to have a more informed discussion with them. If you don't know what to discuss in the first place, you can't do anything about it. **Knowledge is everything.**

"My Mate Down The Pub" Syndrome

Do you have a mate down the pub that makes about the same amount as you do but his accountant sorts it out for him not to have to pay any tax, and wonder **why your tax bills so high**?

Many accountants are familiar with this type of story, told by their clients.

Lets take a look at the reality of this….

Does your mate declare all his earnings to his accountant, (and hence to the Taxman)? Perhaps there is a large amount of **cash takings** that don't go through his books. The accountant may say "any cash takings must go into your accounts", so your mate doesn't let on about cash-in-hand jobs.

Either way, the figure of earnings the accountant is working with is very different to yours, so your tax position will be very different as well. .

This has nothing to do with the skill of the accountant. Your mate is simply exposing himself to the risk of a tax investigation, a process known to have triggered **heart attacks**, depression and nervous breakdowns. You don't want this.

Also, many people like to brag about their accountant. After all, it's a reflection of the good choice they made. After **a few pints**, don't believe everything you're told.

There is so much you can do legally, so please do it and you'll have less need to act illegally.

Tax Evasion v Tax Avoidance & Why The Taxman Isn't Always Right

In very simple terms, **tax avoidance is legal, but tax evasion is illegal** and you risk prosecution for breaking the law**.** However, in some sophisticated cases the Taxman has been trying to blur the boundaries and claim some forms of tax avoidance are illegal.

A few examples will show the difference…

- The most common example of Tax Evasion amongst small businesses is making **cash sales** and not putting this money into your bank account or recording it in your accounting records, so the tax man will never know about it, or so you think!

- A slightly more thought out example, may be making up some **forged purchase invoices**. You write out the cheques to pay them with the name of the fictitious supplier on the cheque stub but it's actually made payable to you and goes into a secret offshore account. Again, this is tax evasion and is illegal.

- Choosing to run your business as a Limited Company rather than as a sole trader in order to benefit from lower rates of tax paid by Limited Companies is an example of tax avoidance and is **legal**.

But it's not always black and white, there are grey areas…

- ☐This may be because the **law itself is in question** or the facts of your particular case are in question. It often arises that HMRC may interpret something in one way, surprisingly to their advantage, but the accountant and the taxpayer may interpret it differently.

- ☐Please remember that **HMRC do not make the law of the land** and they often get it wrong. Be prepared to stand up for your rights if necessary and don't be bullied by them.

- ☐You should fight HMRC on technical grounds, but you need to be very sure of your facts and the law. If you can't come to an agreement with HMRC, the matter normally ends up before the first tier Tax Tribunals who are an informal independent Tax Court to decide the matter. **Many accountants don't like going to the tribunal** but they shouldn't be afraid to go if they have a reasonable argument.

- ☐HMRC know it costs you money in accountants' fees to argue with them and you may back down as the tax saved is not worth it after paying your accountant. In these situations look at getting your accountant to work on a **no win, no fee basis** for you.

- ☐This report will point out any grey areas and the risks, so that you are fully informed. **Taking a small, calculated risk can be a legitimate business decision.**

Do Your Tax Planning In Advance

Tax planning needs to be in advance, not after the year-end. Many small businesses will meet their <u>accountant after the year-end</u> to go through their accounts – **that's no good at all.**

Perhaps after the year-end your accountant suggests putting some wife's wages through the accounts to keep the tax bill down - **<u>this can really harm your financial health</u>** and you'll find out why in this report. Get it right at the beginning and you can do it. If not…face the consequences.

Pre year-end tax planning can be useful but you can't beat doing most of the planning before the year even starts. The sooner you act, the sooner you'll save the tax.

TAX WARNING AGAIN

Do not attempt to implement any tax idea in this report without talking to an accountant who specialises in tax planning first to get full information on the idea in your own personal circumstances, as not all ideas may be suitable for **you**.

OK, so that's the background. Let's get on with looking at where you can save tax…

Section 2

Understand The Taxes That Are Out To Bite You

"The Income Tax People Are Very Nice. They're letting me keep my own mother"
Henny Youngman

You probably want to go straight into the more interesting tax planning stuff, but it helps to make sure you have a basic knowledge of the main taxes and terminology you'll encounter as a small business owner.

This is a summary of the most important aspects.

The tax year runs from **6th April to the following 5th April**. It's an historical thing dating back to 1752 when England changed from the Julian calendar to the Gregorian calendar, and lost 11 days. The end of the financial year was always 25 March, so when 11 days were lost 25 March became 5 April. The rates and allowances in this report are for the 2019/20tax year.

Income Tax (IT)

Every individual person, including children pay tax at the following rates…

- The first £12,570 – this is tax free and is known as your personal allowance. It is reduced for those earning over £100,000 by £1 for every £2 of gross income above this limit.
- The next £37,700 is taxed at 20%
- From £50,271 to £150,000 – taxed at 40% (higher rate)
- Everything above that (meaning over £150,000) - taxed at 45% (additional rate).
- The first £2,000 of dividends you receive will be tax free.

A personal savings allowance is available, this means no tax is paid on £1,000 of savings income for basic rate taxpayers and £500 for higher rate taxpayers.

Income Tax (IT Scottish Taxpayer)

Every individual person, including children pay tax at the following rates…

- The first £12,570 – this is tax free and is known as your personal allowance. It is reduced for those earning over £100,000 by £1 for every £2 of gross income above this limit.

- The next £2,096 is taxed at 19% known as the Starter rate

- From £14,668 to £25,296 is taxed at 20% known as Basic rate
- From £25,297 to £43,662 is taxed at 21% known as Intermediate rate
- From £43,663 to £150,000 is taxed at 41% known as Higher rate
- Everything above £150,000 is taxed at 46% known as Top rate
- The first £2,000 of dividends you receive will be tax free.

A personal savings allowance is available, this means no tax is paid on £1,000 of savings income for basic rate taxpayers and £500 for higher rate taxpayers.

Income Tax (IT Welsh Taxpayer)
Every individual person, including children pay tax at the following rates…

- The first £12,570 – this is tax free and is known as your personal allowance. It is reduced for those earning over £100,000 by £1 for every £2 of gross income above this limit.
- The next £37,700 is taxed at 20%
- From £50,271 to £150,000 – taxed at 40% (higher rate)
- Everything above that (meaning over £150,000) - taxed at 45% (additional rate).

- The first £2,000 of dividends you receive will be tax free.

A personal savings allowance is available, this means no tax is paid on £1,000 of savings income for basic rate taxpayers and £500 for higher rate taxpayers.

The main types of income most relevant to small business owners are:

☐ The profit you make as a sole trader, or your share of the profits you make as a partner in the business.

It helps to explain what this is…

- Your **profit and loss account** is simply all your business income for the whole year less all your business expenses for the year. It is normally prepared on an accruals basis, which means sales count as income whether you've been paid for them yet or not, and the same applies for expenses.

- The **Balance Sheet** is optional for small businesses as it is less relevant for tax purposes. It shows the assets and liabilities of your business on the last day of your financial year. The Taxman may want to see the balance sheet to understand how much money you have personally invested in the business.

- The profit shown on your accounts isn't necessarily the profit you are taxed on. Your accountant will often produce a **tax computation**, changing your accounts profit to a taxable profit. This normally covers items in your accounts that are not allowed as deductions for tax purposes. Examples are a proportion of your motor expenses which represent the private use of your car and claims for capital allowances on equipment you have purchased. .

  Make sure your accountant explains these adjustments to you so that you can agree with them.

☐If you operate through a Limited Company, it's important to understand that the Company is a legal person in its own right that pays corporation tax, not income tax. However, you are normally the Director who runs the company and may earn a **salary** liable to income tax as well as a shareholder who receives **dividends** liable to income tax.

Both the salary and the dividend form part of your taxable income, although the Dividends are taxed a bit differently, which will be covered when we get to tax planning with dividends.

☐You may have other sources of income that count towards your own individual taxable income such as **rental income** from a property you rent out, **interest on bank and building society accounts** (taxed at slightly different rates), etc but we're going to be mainly interested in this report on your business situation as this is where the main tax savings will come from.

National Insurance (NI)

☐If you are **self-employed** as a sole trader or a partner you pay two types of National Insurance:

Class 2 National Insurance that is fixed at £3.05 per week

Class 4 National Insurance on your taxable profits at:

9% on the profits between £ 9,568 and £ 50,270

Plus

2% on any profits over £ 50,270.

- If you are an employee, and that's you if you're a Director of your own Limited Company, there are three types of National Insurance to worry you. The most common rates, unless you are contracted out of the state pension scheme are:

Employees class 1 National Insurance (paid by you)–
First £ 9,568 per year – nothing
Next £41,702– 12%
Everything above £ 50,270 – 2%

Employers class 1 National Insurance (paid by your company)–
First £9,568 per year – nothing
Everything above that – 13.8%

Class 1A National Insurance (paid by your company)–
Paid on the value of benefits provided by your company – 13.8%

Corporation Tax (CT)

- It's paid by Limited Companies on their taxable profits.
- The main rate of corporation tax is 19%.

Salaries paid to directors are deducted in arriving at the taxable profits but dividends are not.

For taxpayers, dividends up to £2,000 attract no income tax at all for those in the basic rate tax band, there is further tax to pay at 7.5% for those in the higher rate tax band, there is further tax to pay of 32.5% of the dividend and for those in the additional higher rate tax band there is further tax to pay of 38.1% of the gross dividend. Simple!

Capital Gains Tax (CGT)

- It's a tax on gains made on disposing of capital assets, such as shares, selling your business and property, although your main home is not normally subject to CGT.
- The first £12,300 of gains you make in a year are exempt from tax. This is known as your annual exemption.
- Capital gains are taxed at a higher rate of 20% for gains (28% for residential property gains) where total taxable gains and income are above the income tax basic rate band of £50,270. Below that an 10% rate is applied (28% for residential property gains). There are various reliefs available that can reduce this.
- Most of the legislation regarding capital gains tax is all about the exemptions and how to avoid it, so you often find there are ways around it or ways to lessen its impact

Inheritance Tax (IHT)

If you're worth more than **£325,000** dead, there's 40% tax to be paid on the excess. You are also entitled to any unused allowance of former deceased spouses or civil partners up to a maximum of another £325,000.

There's not that much you can do when you're dead, but there is something, which this report will explain.

The injustice of the tax is that it's a tax on wealth you have accumulated and already paid tax on whilst accumulating. **Who said taxes were fair?**

Stamp Duty Land Tax (SDLT)

This tax applies on property transactions in the UK.

From 4th December 2014, Stamp Duty Land Tax (SDLT) will be charged at each rate on the portion of the purchase price which falls within each rate band.
£0 to £125,000 - 0%
£125,001 to £250,000 - 2%
£250,000 to £925,000 - 5%
£925,000 to £1.5million - 10%
Over £1.5million - 12%

The SDLT on commercial property starts at £150,000 and it also applies to leases as well as to freehold sales. However, there are a number of exemptions from this tax.

Value Added Tax (VAT)

A business with taxable supplies (basically sales) **above £85,000** a year (from 1 April 2017) needs to **register** for VAT.

The business must then charge VAT on their sales to the customer which they then pay over to HMRC. They can however reclaim any VAT they pay on the purchases they use for the business.

Business Rates

Another form of tax in disguise for small businesses is business rates, also known as unified Business rates (UBR). We will take a quick look at how it might affect small businesses **working from home** so you can make sure you avoid it. There are also special discount schemes for small businesses.

Penalties, Surcharges & Interest

Every tax seems to also have provision for these if you don't do things on time or act illegally.

Let's move on to the more interesting stuff…

Section 3

Choosing The Right Business Structure

Sole Trader, Partnership or Limited Company – You can get to choose how much tax you want to pay

Unincorporated Or Incorporated – What's The Difference?

The main **non-tax benefit** of a Limited Company or a Limited Liability Partnership (LLP) is the protection from **unlimited liability** in the event you can't pay your creditors.

But we're going to concentrate here on just the main tax issues.

So let's look at why you should have a Limited Company from a tax point of view…

- ☐Limited Companies pay corporation tax at **19%** on all of their profits but individuals (sole traders and partners) pay tax at a range of rates from 0% to an effective top rate of 47% (including national insurance), on different slices of their income.
  So, it's possible to pay less in tax by working through a limited company, but it does depend on the level of your total income and hence the total tax you would pay as an individual.

  If you have £30,000 of profits liable to 40% tax and 2% NI (meaning your total income is about £72,000), the tax & NI saving can be £30,000 x 22% =£6,600 every year on this alone.

- ☐Sole traders and partners pay Class 2 & Class 4 National Insurance on all of their profits, but Limited Companies only pay national insurance on salaries and benefits paid to the employees and directors. For someone earning £30,000 in a year, the amount of class 2 and Class 4 NI to be saved is just over £2,000.

- You can get benefits of incorporating at very low profit levels as long as you do not pay all of the net profits out of the company as salary and benefits.

Is there a catch?
Possibly. There are additional costs involved in running a company such as more administration and higher accountancy fees.

With a Limited Company you have to consider how much money you want to **take out** of it and pay to yourself. But this flexibility can be used to your advantage.

When you take money out it gets taxed on you **personally**. The two main ways to take money out are either as a **dividend** or as a **salary** and we'll compare them more later but we're are going to assume dividends are being used as these are normally the most beneficial to small business owners.

Assuming you can use dividends, you don't pay any tax on the first £2,000 received and 7.5% tax on these up to your **basic rate tax band** of £50,270 but you pay 32.5% on dividends above this amount (and 38.1% for those in the additional rate tax band). If you add this to the 20% your company is paying, it then doesn't look so great.

However, if you are happy to only take income out up to the basic rate band threshold (£50,270) and leave the excess profits in the company you can pay far less tax. This means Limited Companies can work for people making good profits who want to reinvest the profits of their business above £50,270 into the business, or are possibly happy to leave the profits in their company until a later year when they are making less, and take the money out then.

Property Developers are one trade where this is often the reason to leave the profits in the company, to buy the next property.

If you want to get your hands on all the money your Limited Company makes straight away, the benefits aren't that great.

But I'll Get Taxed On A Company Car Benefit If I Use A Limited Company

Yes, if your limited company owns a car that you use **privately** to any extent whatsoever, you'll be taxed on a benefit in kind because as a director you are an employee of the company. This doesn't apply to sole traders and partners.

This benefit is based on the list price and CO_2 emissions of the car but recent years have seen great increases in these benefits. So how do you get around it?

> You could own the car personally and you are then allowed to charge your company the HMRC approved mileage allowance of 45p per mile for the first 10,000 business miles and 25p per mile thereafter. This is paid **tax free** to you and the company gets tax relief on the payment.

This does vary from case to case and you should get your accountant to do the calculation in your own case to see if it is best to hold the car in your company, or in your own name.

Which is going to be best will depend on the car, the business mileage you do, etc. You don't have this problem to consider if you trade as sole trader or partner although you can still use the HMRC mileage allowances if you prefer.

If the car is held in the company it may be worth considering the employee contributing to the cost of the car. **Contributions** of up to £5,000 reduce the list price on which the taxable benefit is paid. It is worth noting that a company can lend an employee up to £5,000 interest free without a benefit in kind being taxable on them.

You have to **crunch the numbers** in every situation but generally you are better holding the car outside of your company, unless it is a very low emissions car which qualifies for a 100% capital allowance for the company. However, holding the car personally rather than in the company does not mean you can't benefit from the other tax advantages of using a Limited Company.

If your accountant says you shouldn't consider using a Limited Company without explaining why, just check it's not because he can't handle Limited Companies.

I Need Some Net Relevant Earnings For My Personal Pension

Not any longer. Since 6 April 2006 you can pay **any amount** you want into a personal pension scheme, but the level of contribution you receive tax relief for is restricted to 100% of your earnings. However, if you have little or no earnings you can still get tax relief on up to £3,600 of pension contributions per year.

The point is, dividends don't count as earnings but sole trader and partner profits do. This would suggest that using a Limited Company and extracting most of your income as dividends will restrict the amount of pension contributions you can get tax relief for. This is not the case, for reasons we explain later in section 9: **Pension Matters**.

How To Get The Best Of Both Worlds

The **best tax structures** often end up with one business being **split into two** distinct businesses, one running as a Limited Company and one as a sole trader/partnership to get the best of both worlds.

The cars are normally held in the unincorporated side of the business where the business travel is carried out and the Limited Company makes the profits that you want to retain to grow the business. There can also be VAT advantages where the two businesses serve different types of customers.

You need to set this up correctly and under no circumstances should you do it without **proper advice** from your accountant first.

You can even have a business with a business structure such as a partnership but with one of the partners being a limited company.

There is a lot that is possible once you start to **put your mind to it**.

What About Limited Liability Partnerships?

Before the Limited Liability Partnerships (LLPs) were introduced in 2001, the choice between a Limited Company and a partnership revolved mainly around tax and limited liability considerations.

Sometimes the tax benefits of a partnership, particularly with regard to cars and pension contributions had to be traded against the benefit that **limited liability** provided to the personal assets of the business owner.

If the best tax solution was a partnership but commercial prudence indicated a Limited Company, there was a problem.

The introduction of the Limited Liability Partnership has changed this so that you should now be able to get the tax advantages of a partnership combined with the benefits of limited liability.

Again, there is more administration and normally higher accountancy fees in dealing with a Limited Liability Partnership.

Using Losses For Start Up Businesses

When you start up a business, it can sometimes be worth starting off as a sole trader or partnership.

This is when you are most likely to make losses in the first four years, as with a sole trader or partnership those losses can be **carried back** against your other income sources from earlier years to produce tax rebates. Limited Company losses can't be used in this way.

Transferring Your Business Into A Limited Company

If you decide you've got the wrong structure and want to become Limited, there are some other tax issues to consider, although the legislation generally works to make it far easier for you to incorporate than to disincorporate…

- **Your final income tax bill -** will be determined by when your old unincorporated business ceased to trade and there could be a sizeable income tax bill on it's profits to cessation depending on the **overlap relief** you have available. Your accountant will calculate this for you.

- **Parallel trading** – may help you reduce the large tax bills that can arise when your unincorporated business ceases to trade. You start running new contracts through your new company, and leave the old contracts to run down in your old unincorporated business. The two businesses run side by side until all the trade has gradually moved over to the new company. This will not suit everyone.

- **Capital Allowances** - you can elect to transfer all your business assets to the new company at their tax written down value rather than their market value. Any credit to a directors loan account for value transferred is still based on market value which can be very beneficial to you in being able to draw money tax free from the company.
  The best time to transfer assets needs to be calculated. There is no writing down allowance given in the final period to the unincorporated business that is ceasing, so it can help to transfer the business shortly after a year-end to avoid losing out on this.

- **Unused trading losses** cannot be carried forward to your company but you can set them off against income you get from the company, such as salary.

- **Trading stock** – the legislation normally requires this to be transferred at market value. However, as long as the stock is not gifted to the company, an election can be made for the greater of cost or price paid by the company to be used instead if that would produce a lower figure.

☐**Capital Gains Tax** is relevant because when the assets are transferred to the company they are valued at market value for capital gains tax purposes. The principal assets that can create a capital gains tax charge are property and the goodwill of the business .

There are 2 different ways around this but you need to plan which is best for you. It involves either transferring the assets in exchange for shares in the company or the assets being gifted to the company.

If you don't use the shares route, you can also transfer a lot of the assets in exchange for a credit to your director's loan account that you can then draw on **tax-free**. You may not want to transfer all your assets; property being a good example of one often held outside a company and so both options won't be open to you. Both have their pros and cons.

You may not want a relief for CGT on incorporation at all. Suppose your goodwill is valued at £12,000, this is covered by your annual CGT exemption. There is now no CGT to pay and you have a loan account of £12,000 you can draw on tax free from your company. It is however, critical to ensure the £12,000 valuation is correct and this is a specialist area to get advice on. Not all types of business goodwill can be transferred to the company.

☐**Stamp duty** land tax needs to be considered on the transfer of any property to the company, and this will include the transfer of a lease. .

☐**VAT -** Because the transfer of a whole trading business is treated as a **transfer of a trade as a going concern**, VAT is not normally charged on the transfer of the assets and stock. However if you are transferring land & buildings you will need to get specialist VAT advice.

So don't incorporate your business **without getting expert advice first** as there is a lot to consider.

Section 4

How To Minimise Your Business Profits For Tax Purposes

"Income tax returns are the most imaginative fiction being written today"
Herman Wouk

Most of this section is going to apply whether you choose to operate as a sole trader, partnership or limited company.

Claim Every Cost You Incur In Running Your Business

If you pay for something connected to running your business make sure you keep a record of it.

Normally, you'll get a **receipt** but many people think that if they haven't got a receipt they can't claim for it – **not true**. It's often the little items of expenditure that are not claimed, but over a year they can add up to a few thousand pounds, just as smoking a pack of cigarettes every day does.

As an aside, with over 80% of the price of cigarettes just tax, another tax saving device is to **stop smoking.**

The test is whether you can **satisfy** HMRC that you incurred the expense. So, if you pay for something in **cash** but don't have a receipt, still record it and anything that would help satisfy the HMRC you incurred the expense.

For example…

> You buy a piece of equipment in cash from a nomadic traveller for £300 who won't give you a receipt. Still record what you bought, when, from whom and how much you paid. You have this item of equipment that you can prove if necessary because it physically

exists. You must reasonably have purchased it and so by noting a few details down, it will help to satisfy HMRC.

The same is true for anyone who wants paying in cash and didn't give you a receipt. If it's a business expense, you're entitled to claim it so long as you can satisfy a **reasonable tax inspector**. The more information you have, the better. This is not the case if you want to reclaim any VAT charged on the item as different rules apply.

Small items you might not have receipts for, such as car parking. If you haven't kept a record there's no reason why you can't **estimate** on a sensible basis, how much you've spent over the year. If you calculate it sensibly, you can satisfy HMRC. It would of course be better to record them as you go to avoid any debate over it.

For VAT purposes you claim back VAT on expenses without a VAT receipt if you are VAT registered and they are under £25 for…

1. Car parking apart from on-street meter parking which is outside the scope of VAT.
2. Phone calls from public or private telephones.
3. Purchases from coin operated machines.
4. Road tolls.

You Work From Home So Claim The Cost of Running Your Home

☐ You can claim any additional expenses that are incurred through working from home.

☐ HMRC allow you to claim a **proportion** of costs that are part private and part business.

☐ At one extreme, you may have a dedicated office at home just used for the purposes of the business. You can therefore claim on a sensible pro rata basis a proportion of the running costs of the whole home, including insurance, heat & light, repairs, council tax, mortgage interest, etc. The Taxman may dispute the **mortgage interest** but there are many situations where it is claimable.

☐ You can calculate the proportion of expenses to claim on a square footage basis (office compared to total area of the home) or as a ratio of the office to the total number of rooms in the home (excluding hallways & bathrooms) .

☐ If you can sensibly argue that the cost of **heat and light** used for the business is actually higher than worked out with this formula, because you're at home all day working, then claim whatever is sensible. Just keep a record of the calculation.

☐ If an office has been built specifically for the business and you financed it with a loan, claim all of the **interest on the loan**.

☐The other possibility is where perhaps a room doubles as an office and a spare bedroom for guests. You can calculate the expenses to claim by first apportioning on a pro rata basis as above and then by the proportion of time it is used for business purposes. Where a room is used for two things at the same time, you should not claim for the business use.

☐Your accountant should do the calculation for you but check to see if you think it's high enough. They may have just claimed **£5 per week** without giving any more thought as to whether this is really enough.

☐ Where you operate through a Limited Company, it is best to have some form of **licence** between you (as the property owner) to the company for a payment of rent that is claimed by the company. The rent you receive should then covered by all of the above expenses so you personally make no profit and pay no tax. The rent payable by the company should not exceed the market value of similar office space in a similar location, but it can be less.

☐When you run your own company from your home the company can pay you up to £4 per week for use of the home, without you having to provide any supporting evidence or calculation of the expenses this payment it expected to cover.

But won't I have to pay CGT when I then sell my house for a profit?
The fly in the ointment that is often trotted out by the **ever cautious accountant** is that there will be Capital Gains Tax to pay should the house be sold, and you have claimed for part of it to be used for the business. Well, let's look at the reality of this.

Capital Gains Tax only applies to a part of the home used **exclusively** for business purposes. If the room doubles as a private room as well, there's no CGT to worry about. Even if it is used exclusively, there will in practice probably be no CGT to worry about. Let's explain this…

☐Property prices can go down as well as up– so you could claim a capital loss for tax purposes.

☐The amount of the gain relates only to the **proportion** of the house you have claimed as business use. If it's owned jointly by husband and wife/civil partners, you are both entitled to an annual CGT exemption of £12,000 each, so unless that gain on that bit is more than £24,000 and you have no other capital gains in the year, there'll be no tax to pay.

☐Are you still worried? Well even then, if you move to another house with business use, you are allowed to avoid paying the CGT by what is called **rolling over** the gain into the new house. If not, there are still other assets you could invest in to avoid the CGT. It's probably time to stop worrying and claim for use of home.

Aren't Business Rates payable when I work from home?
Business rates may be due in respect of any part of your home if there is an **exclusive** business use of part of the property. Business rates will be due on that part and Council Tax on the remainder.

However, if there is only part business use of a room, the property will remain banded as wholly domestic unless the business use predominates or structural alterations have been carried out to facilitate business use.

There is also a case which indicates that Business Rates wouldn't be due even if part of the property is used predominantly for business use if no customers or clients visit the home in connection with business.

In summary, business rates are unlikely unless the premises are **advertised** or **planning permission** is sought for business use.

So, to be safe, if you use a room partly for business purposes and partly for private, you'll be OK.

Minimise your business rates

Business rates are just another tax on your business, but unlike other taxes they can be deducted from your profits as a business expenses. All types of business premises are liable to business rates including holiday cottages and guesthouses.

The rates are based on the rateable value of the premises, which are recalculated every five years. If you think the rateable value of your premises has been set too high you can appeal.

The national uniform business rate is multiplied by the rateable value to reach the level of business rates you must pay each year. However this bill may be reduced by the following reliefs:

- Rural rate relief for essential services such as shops and petrol stations;
- Relief for charities and non-profit making organisations such as amateur sports clubs;
- Small business relief at various rates where the rateable value is below £5,000, £10,000 or £15,000 (£21,500 in London). However, you must claim this, it is not automatic.

Note different rules for business rate relief apply in Wales and Scotland. Northern Ireland uses the old business rates system.

How To Maximise Claims For Expenses With Mixed Business & Private Use

Forget Limited Company situations for a minute, as they don't have private use, because **a company isn't a private person**. Private expenditure on behalf of the director is dealt with by benefits in kind being taxed on them.

However with sole traders and partners, it's different. You may put all your motor expenses through your books. However, when your accountant completes the tax computation he is likely to enter a **proportion,** let's say 25%, of those costs as relating to private expenditure and they are not allowed as a deductible tax expense**.** Accountants refer to these as **add backs.** This proportion may be based on a discussion you had years ago and its no longer up to date.

Many clients don't even know what proportion their accountant is adding back for them, so how do you know if it's right?

Perhaps, it should be far less than what your accountant is doing. Therefore, make sure **find out** what is being added back.

You should be able to satisfy the Tax Inspector that this is reasonable. You should for example, **keep a log** of all your business mileage and make a note of the total mileage for the car over a year, - this can be taken from the MOT certificates. Comparing the business miles to total mileage will give you the right proportion of motoring costs to claim.

The same is true of other mixed expenses such as **use of the home phone** that is also used for **business purposes**.

How To Get Tax Relief For Your Personal Mortgage Interest

Whilst, you can't technically get tax relief on your personal mortgage, there are ways it could be structured so that you effectively do. Follow this example…

- ☐ Let us suppose your business owes you some money, say £20,000 for funds you introduced on start up. You could get your business to repay this to you and use this money to **repay** £20,000 off your mortgage.

- Shortly afterwards when the business wants a similar amount of money to fund the purchase of some equipment, you **take out a loan**, secured against your house. Because you have borrowed the money to finance the purchase of equipment for your business, you can claim tax relief on the interest on the loan.

- You are now in exactly the **same position** as before with a loan secured against your house but now you get tax relief on the interest. You need to check the interest rates but a good relationship with a friendly bank manager may well allow you to borrow at the same rate, as the security is the same. Other than that, just watch out for mortgage redemption fees and loan arrangement fees.

There are many other variations on this basic concept, but <u>the key is to make sure any borrowings you have are business borrowings</u>, not personal borrowings. Then you'll get tax relief on the interest.

If you need to borrow some money, try to make sure that the funds from the loan go directly into the business so that you can claim relief on the loan interest. Get the loan agreement to state the **purpose** as being for a business use if at all possible.

How To Claim For Motor Expenses From Home To Your Place Of Work

The normal rule is that you **can't** claim for travel from your home to place of work.

The obvious way around this is to **make your home your main place of work**. This means whenever you step outside your door, you're on business travel and its tax deductible.

By claiming in your accounts for use of home, it's going to make it easier to substantiate you do work from home. Whether you work from home or not is judged on the **facts** of your case, not where you say your work base is.

If you start work at home each day, go into an office for a meeting and then finish working at home each day, this is clear evidence your base is at home, even though you may also attend an office elsewhere.

Doing the books at home, keeping stock at home, keeping the daily takings at home, interviewing staff at home, etc can all help to substantiate this. It can be one of those grey areas and you should speak to your accountant about what you need to do in your own situation to be able to claim for travel from your home. If you are employed by your own company your employment contract should require you to work from home.

When you travel to a place **other than a regular workplace**, this would always be tax deductible.

How To Maximize Your Capital Allowances Claim

When you purchase a capital asset such as a car or an item of equipment, you don't get tax relief for this expenditure all at once.

Often your accountant will calculate some depreciation on the asset and write the cost off over the useful life of the asset in your accounts. However, whatever the accountant calculates as the **depreciation**, it's not allowed as a deduction for tax purposes.

Instead, your tax computation that accompanies your accounts includes **capital allowances** that are calculated at specific rates as determined by the tax legislation. For example, on plant and machinery, small businesses are entitled to claim 100% of the cost in the year you purchase up to £1M per annum. Over £1M, 18% can be claimed and the remaining balance is then written down by 18% each year.

You get the full 100% tax relief in the accounting year in which you purchase the item, even if that's on the last day of your accounting period. . However the new asset must also be brought into use in the business. So if you are approaching your year end, by buying just **one day earlier,** you get the full 100% relief **one year earlier**, giving a great help to your cash flow.

Beware of falling into the trap of spending money just to save tax. It's hard to understand those people who say, you should buy it because it's tax deductible. Why spend £100 to save £40? But if you're going to spend it anyway, consider when is the best time to make the purchase.

Short Life Asset Elections

For items of plant and equipment that are likely to last less than 8 years, you can elect to treat them as short life assets. This means that rather than being mixed in with all your other items of plant in a general pool, they are separated out so the tax written down value can be monitored separately.
If you sell the short-life asset within 8 years, you can claim the balancing allowance as soon as you sell it.

This is ideal for assets such as computers that tend to have a short shelf life and helps to increase the rate at which you receive capital allowances. Cars don't count as short life assets.

Why It Pays To Not Always Claim Your Capital Allowances

If by claiming your capital allowances, it brought the level of your taxable income below that of where no tax or national insurance is payable (£9,568), then you are **wasting** your personal allowances as any not used can't be carried forward to another year.

Therefore, it can sometimes pay in years when you have a low level of income, **not** to claim or only **partly** claim your capital allowances. This leaves more allowances to be claimed in future years, when you need them.

Is it Advertising Or Entertainment?

This is important **as entertaining is not allowable** for tax and VAT purposes.

Normal advertising of products and services is not a problem, as those costs are fully allowable expenses for income tax, corporation tax and VAT purposes. However when it comes to the likes of promoting your business through having a box at a football club, sponsoring a rally car etc, it may be more difficult. If the cost counts as entertaining, or is not wholly and exclusively for the purpose of the business then it's not allowable.

There needs to be a true attempt to **benefit the business**. The following gives you examples of how to help your case:

- ☐Have the name of your business shown prominently on the rally car..
- ☐Display pictures of the car, (or the actual car) where potential customers will see them.
- ☐Maximise publicity for the car and your business in the local papers and on TV programmes.
- ☐Note any business that does result from the publicity associated with the car.
- ☐Account for business entertainment separately.
- ☐Avoid sponsoring a sport in which owners of the business are personally involved.

Claim An Accrual For Holiday Pay In Your Accounts

If your business year-end is **different** from your holiday year for employees you could claim a deduction in your accounts for holidays that have accrued but not yet been taken by your employees at your year-end.

With the requirement now to give employees 28 days paid holiday a year you may be giving more holiday than before and this may now be a more worthwhile exercise.

If your year end is the same as your holiday year then all holiday has been taken by the year end or is waived (unless you allow employees to carry it over), in which case there is no accrued liability for holidays.

For example, assume your accounts year-end is the end of June and your holiday year goes to the end of December. At the end of June, your employees may have accrued an entitlement to half a year's holiday but they may only have taken a quarter. Therefore, there is an **accrued liability** at the accounts year-end for the other quarter of the holiday pay that can be claimed as a deduction.

Using Your Own Goods For Personal Use

If you use some of the goods you sell for your own personal use, then by law you are taxed on these at their **selling price**.

So the goods cost you £100, you normally sell for £300 and if you take some for personal use, you have to pay tax on £200. This seems **grossly unfair**, but it's the law.

One way around it is to use your personal relationships with your suppliers to get them to sell directly to you personally at your cost prices and you pay for them personally. This then avoids the problem.

Valuing Stock To Save Tax

Take a fresh look at your stock valuation at the end of the year that goes in your accounts if you buy and sell goods.

Stock should be valued at cost, but can be valued at **net realisable value** if this is a lower figure. In simple language this means valued at what you could get for it. This is often the case with stock that is obsolete or perishable.

Every pound by which you reduce the stock value will reduce your taxable profits for that year. It **shifts** the profit into the next year, so delaying payment of tax. It is especially important if you want to shift profit from a year in which you are paying higher rate tax to one when you are likely to pay basic rate tax. Then you **save** tax as well as delaying payment by a year.

Note if you subsequently sell the stock you have written down for a significantly higher value, the Taxman may well insist on adjusting your accounts for the earlier year and charge you additional tax and interest.

Get The Best Year End For Your Business

You don't have to make up accounts that follow the tax year; it's **up to you** what your year-end is.

If you are a sole trader or partner, your tax bill for a tax year is worked out by reference to the profits of the accounting year ending in that tax year.

For example, if your accounts run to 30th June 2020, these accounts will form the basis of your tax bill for the tax year 2019/20 (6/4/19 to 5/4/20).

However when a business **starts** and **finishes** or changes its year-end, there are slightly more complicated rules. Without going into all the details of these as it may well confuse or bore you, you're going to have to accept what follows on trust for the time being.

If you have a new business starting that you expect to have lower profits in its first year than subsequent years, a year end **early** in the tax year such as 30th April will help keep your tax bills down in the early years. It could however lead to a larger bill when you cease. In addition, having a year-end early in the tax year, helps give you more time to plan for your tax bills.

You should also consider if your business is **seasonal.** For example**,** if you sell lots around Christmas time, you don't want all those profits you make in December falling into your accounts by having a December year-end. If you had a November year-end, you could **delay** paying the tax for another year by just shifting your year-end by one month. It's also easier to do a stock take at a time when you're not busy.

Changing Your Accounting Date Can Also Help

If you are an existing unincorporated business that has **rising profits**, a change to an accounts year-end falling **earlier** in the tax year will lower your tax bills and if **falling** profits, a **later** year end will help. The calculations get a bit more complex, so just take it on trust again.

There are restrictions on how often you can change your year-end but it can be worth crunching the numbers where you have rising or falling profits.

When HMRC Come To Visit

When HMRC ask to **visit** your business let your accountant deal with the visit if possible, or ask the Taxman/VATman to send his queries in writing to your accountant. You don’t have to answer the Taxman’s questions immediately, especially if you do not have all the information he requires to hand. A misplaced comment or guess may cost you dear! The end of this report covers tax investigations in more detail for you.

Section 5

Especially For Limited Companies

The most criminal error is not getting the basic advice on how to extract profit from your company

The Big Argument of Dividends Versus Salary

What's the argument? In the vast majority of situations with a small limited company, dividends are the answer and yet it's still amazing the number of companies that don't use them to their full effect.

Let's go through the argument based on the **normal small businesses situation**, not all the more complicated scenarios only relevant to very high earners already taking large salaries and deciding to whether to take their bonus as salary or dividend.

We're interested in how you get your basic money out of the company. Let's **keep it simple** because it's not complicated…

- If you pay a salary, it attracts both employees National Insurance (mainly at 12%) and Employers NI (mainly at 13.8%). Dividends have no NI. It's that simple!

- The corporation tax situation is that by using dividends, the company doesn't get any deduction from its profits so it is paying 19% corporation tax. The first £2,000 of dividends you receive are tax free, any dividends, if you are a basic rate tax payer you will pay 7.5% on any further dividends you receive. As an individual in the higher rate tax band you will pay a further 32.5% on the amount dividends paid out by the company. If you are in the additional rate band you will pay 38.1% on these dividends.

  For simplicity, we will add the tax paid by the company to the tax you pay personally and call the total tax paid either 37% tax for basic rate taxpayers and 52.5% for the higher rate band taxpayers.

If you pay a salary, you are largely paying either 20% basic rate tax or 40% rate tax so we can see the tax differences are small compared to the National Insurance benefits.

How much money are we talking about?
Take a straightforward situation of a small Limited Company where the choice is between taking £40,000 salary or £40,000 dividend. If we just look at the National Insurance savings, these come to over **£8000 per year**. It's obvious which to go for and yet often small businesses are not doing this. It's the **one of the biggest sins** in tax planning not to have considered it.

Are there any reasons why they wouldn't be using dividends? Occasionally there are…

☐ If your company hasn't made enough **profits** since it started to cover the dividends that you want to pay, then Company Law prevents dividends being paid.

☐ If you want to pay a lot into **pensions** you used to need a salary high enough to justify the contribution, but that is no longer is a restriction for most pension schemes. See Section 9: Pensions..

☐ You believe you can only have a dividend once a year and you need your money every month. <u>This isn't true.</u> There is no set interval for dividend payments prescribed by law. Quarterly payments are recommended but if you need monthly cash, that can be done.

☐ You may not want to pay dividends because you **have other shareholders** that would need paying as well. You can look to get around this by using different classes of shares for different shareholders. More on this below.

☐ Paying dividends may increase the value of the company for Capital Gains or Inheritance Tax consequences in the future. In the author's experience, this rarely applies in practice with small companies.

☐ You're worried about the **minimum wage legislation** and believe you have to pay a salary to cover this. However, minimum wage legislation doesn't apply to people living in a family and working in the family business. This doesn't include Limited Companies but as far as working directors are concerned who don't have an explicit contract of employment, they are not subject to minimum wage legislation, so don't give them one.

Don't I Need A Salary To Pay Some National Insurance To Preserve My State Benefits?

As long as you pay more than £6,240 a year in salary, you will still be entitled to all the main state benefits including your primary old age pension and there is still no National Insurance to pay until the salary gets to £9,568. Amazing, you really can get something for nothing.

So the best mixture is to often pay yourself a salary of this level and everything else by dividends.

Pay Dividends Correctly – Or Pay The Consequences

Now that you've decided saving say £8,000 every year is a worthwhile exercise, it's important you pay the dividends correctly to make sure there is **no dispute** as to what they are. This is an area of tax planning that HMRC may want to attack in future years. You don't want the Taxman wanting to treat the payments as a loan to you or even as salary.

If the dividends are treated as a **loan**, which is the Taxman's most likely approach if you do things wrong, the company must pay 25% of the loan over to HMRC, and you are personally assessed to a benefit for having an interest free loan from your company. So this is what you need to do…

☐ You need to know you have enough **retained profits** to be able to pay the dividends by law. Retained profits are all profits since the company started that haven't already been paid out as dividends. If you produce monthly management accounts, that'll be easy. If not, you need to be able to justify by some other method whether you have enough profits or not. So long as you reasonably believed there to be enough retained profits, that's OK.

☐ Check your company's Articles of Association as to who can recommend and authorise a dividend. The directors of the company will normally recommend the dividend, and the shareholders will approve that recommendation.

☐ Pass a **company resolution** authorising the dividend. A simple standard word-processed document can be used, which we can provide to you.

It is important that it specifically mentions you have considered the retained profits position before paying the dividend. Just fill in the blanks whenever you want to pay a dividend, sign and date it.

Make sure you do this at the time. Did you know HMRC do have the technology to subsequently look at a document and date it by the age of the ink? **You've been warned.**

- ☐Issue a **dividend voucher** to the shareholder. Again, standard vouchers where you just fill the blanks in are available.

- ☐Make the right **accounting entry** in your records. Call it dividends, not salary.

- ☐**Pay the dividend** by cheque or bank transfer, not just by a credit to your director's loan account in your accounting records.

The worst thing you can do is take money throughout the year without any acknowledgement of what it is and then let your **accountant** treat it as **dividends at the end of the year**.

For example, having your company settle a personal credit card bill and then trying to classify this at the end of the year as dividends is fraught with danger. Strictly, PAYE/NIC procedures should be considered at the time of payment as to what the payment actually is and the payment of a personal bill will normally be considered to be salary with all its PAYE & NIC consequences. It is far better not to ask the company to settle personal liabilities, but get the company to pay you reimburse you for business expenses you have incurred, on the basis of an expense claim you submit which is supported by receipts..

The reality is the company will often pick up personal bills, because many small company owners treat the company bank account as their own but in law it's not.

You're entitled to the money but how you extract it from the company matters if you want to minimise your tax bills. If you get it wrong, you run the risk of the amounts paid being allocated to an overdrawn directors loan account so that the Taxman then wants to assess you on an interest free loan benefit from your company.

Why Use Different Classes Of Shares?

You, the **main worker** in the business may want to take some of the profits of the business by dividends rather than a salary/bonus to save both the employees and the employers national insurance.

However, when a company pays out a dividend, **every shareholder** gets a slice of the dividend according to their shareholding and you may not want to pay them.

When most companies are formed they have just one class of share so that any dividend payments benefit all shareholders, not just you.

If you create different classes of shares and pay each class of share a different dividend this would solve the problem.

For example, if your company has just 100 ordinary shares, has made £100,000 profit and you are a 50% shareholder you could pay it all out as dividends and you would receive £50,000 as would the remaining shareholders between them. However if all the shareholders agree, you could pay whatever dividends you wanted on the different classes of share.

This is an area HMRC may attack, particularly where shares with minimal rights are given to certain employees to try to just change their salary into dividends. So expert advice in setting it up correctly is essential.

It's My Company; I'll Treat The Company Bank Account As My Own If I Want

If you use your company to pay for some personal items, these are normally allocated to your directors' loan account. This is treated as an **interest free loan** from the company to you because in law the company is a **separate legal person**. This then creates what is known as an overdrawn director loan account.

The tax implications arising are as follows…

- Because the loan is interest free there will be a **taxable benefit** on you based on the interest you should have paid at the official rate of interest.
- You need to declare the loan on your Corporation Tax Return. If you don't and it is spotted you are at an **increased risk of an enquiry**.
- If the loan is still outstanding more than 9 months after the company's year end, the company has to pay 25% of the amount of the loan to the Taxman. If after this, the loan is **repaid** you can get this money back but not until 9 months after end of the next years accounting period.

There are some ways around these problems:

- If the loan is less than £10,000 you won't be assessed to a benefit in kind on the interest free loan. If the company has directors who are **husband and wife**, try to split the loan between you so that you both get below the £10,000 limit.
- You could pay yourself a dividend and instead of keeping the money pay it back to the company to clear the overdrawn loan account. You should let the company cheque **clear** before writing out the personal cheque!

The moral is to try to avoid treating your company bank account as your personal bank account. Use proper dividend procedures.

The Directors Loan Account Write Off

The traditional way of clearing an overdrawn directors loan account has been to pay a dividend to clear it. However, what if the company can't pay a dividend because it doesn't have enough retained profits or a dividend is not wanted because other shareholders would also benefit?

One answer is to get the company to formally write off the loan account. The amount written off can then be treated just as if it were a dividend for tax purposes. The loan should be made and written off because of your position as a shareholder rather than as remuneration from your position as an employee to avoid the Taxman trying to suggest the write off is an emolument liable to NI.

Granting A Licence To Extract Profit From Your Company

If you have created some intellectual property such as design for a product, or a software programme, why not allow your company to use it under a licence.

If this was someone else's idea your company may well purchase it from them on a licence, so why not apply this to you as well.

The tax advantage is that there is **no National Insurance** payable on the amounts paid under the licence. To make it legitimate, ensure you don't incur costs in the company in developing this idea.

To work out how much to charge for the licence you could contact an intellectual property or patent agent as it is important that the charge is at **market value** to avoid it being disallowed by the Taxman.

Alternatively you could sell the intellectual property to the company, the proceeds of which would normally be treated as a **capital gain** in your hands**.** Where the gain is no more than £12,300 you will not pay any tax, as this is below the annual Capital Gains Tax exemption.

An amount of exactly £12,300 may be a bit suspicious but if it's legitimate, that's fine. However beware of over-egging the value, as the sale should be made at a fair market value. You will be subject to **income tax** on any amount paid in excess of the market value.

Make sure you raise a sales invoice from you to the company to evidence the transaction and enter it into the accounting records. All the paperwork for transactions between persons connected with the company needs to be totally watertight as this is an area HMRC will look at. A licence agreement should be prepared.

Using Inter Company Management Charges

By raising management charges from one company to another you produce income in one company and expenditure in the other. It's just a form of sale from one company to another.

You may find that it would be tax efficient to move profits from one company to another. This can help to **move losses** of one company into another to reduce their tax bill or equalise the small companies rate band between **associated companies** as discussed above.

The Taxman may attack this on the grounds the management charge is excessive and just being done to achieve a tax saving. It is therefore not for a commercial purpose and not wholly and exclusively for the purposes of the business and will want to **disallow** it.

There will also be VAT to be charged on the management charge if the two companies are not within the same VAT group, but are registered for VAT. Beware of making a management charge from a company that is VAT registered to one that is not.

A management charge often sticks out like a sore thumb in the accounts and so is often easy to pick up on.

To substantiate the management charge you want to be able to show what services are being provided.

This could for example be staff spending time working for the other company, part of the premises of one company being used by the other, etc.

If you can show the market rate for such services is equal to the management charge you should be OK.

> This doesn't have to be cost to you; it is a commercial transaction after all. The fact that a customer pays **over the odds** does also not make it a non-commercial transaction. If the other company needed the staff urgently, a high premium would be more acceptable.

You get the idea!

If the Taxman challenges it, only the part you can't justify should be disallowed, not the whole lot.

Should You Or Your Company Buy The Business Premises?

There is a clear tax advantage of one over the other!

If your company owns the property and it makes a gain when it sells the property then the company will pay corporation tax on the gain. However, if you then want to get your hands on the money the profit is still in the company and you have to pay tax when you take it out from the company. This is the so-called **double tax charge**.

By owning the property personally, you get an **annual CGT exemption** and once taxed, you don't then have to worry about getting the money out of the company. You can also charge a market rent to your company for use of the property. **Entrepreneurs relief** may also be available where the property is owned by you personally but used by your personal trading company as long as the disposal is associated with a disposal of your interest in the shares of the company, although the amount of relief will be restricted where a rent is paid by the company to you personally for the property.

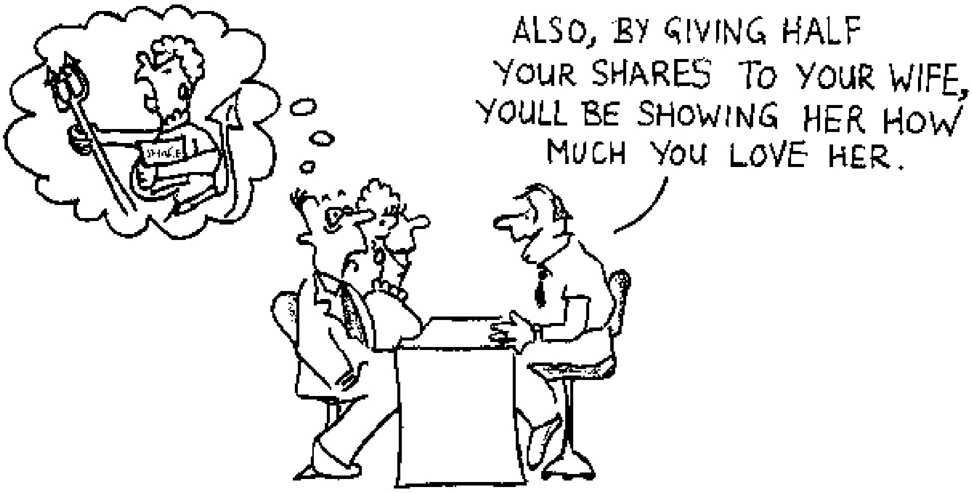
The double taxation problem can also be avoided by having the property in a partnership.

Please ensure you **don't** use company funds to finance the purchase of the property, as this could be treated as remuneration taxable on you.

The other option is to get your **pension fund** to purchase the property so that any gain would be completely tax-free but any profits would be **locked** in your pension fund until you retire. If you want your hands on the money sooner, own the property yourself or in a partnership.

Section 6

Spouses/Civil Partners, Children & Other Family Members



How To Pay Your Spouse/Civil Partner Or Children Wages To Reduce The Tax You Pay

Your spouse/civil partner may not have any income at all, and almost certainly your children don't. This means their personal allowance is being wasted every year. Even children are entitled to a personal allowance.

If the amount up the level at which national insurance becomes payable of £9,568 in 2020/21 was paid to them as a wage, they would pay no tax on it and your business profits could be reduced.

Please note that children under the minimum school leaving age can only work a **limited number of hours** per week and local by-laws may restrict their working hours further.

If you pay just 20% income tax and 9% Class 4 National Insurance this would save you **£2,685 every year** on each salary. And how many children do you have?

STOP! It's not quite that simple. To pay wages like this you need to follow the following rules:

- It must be for **work actually done**. Now it's going to be tough to argue your 2-year-old son is working for you but many wives/husbands do work and mature children may also help out.

  May be they do the books, answer the phone, stuff envelopes, etc. Keeping out of your way so you can get on doesn't count, as valuable as it may be. Draw up a list of their responsibilities to help your case.

  At present they do it for free because it's a family business but they should and can be paid for it. If you make your spouse a director, all the responsibilities of this imposed by Company Law must be worth something.

  You can also do this where you have property that you rent out and the spouse manages the properties.

- If this is the case, it's reasonable to pay them a salary commensurate with what they actually do. How much would it cost to get someone in to do that job? The **minimum wage** level is at least a good place to start but more if you can justify it.

- The amount must actually be **paid**. It's no good the accountant just putting it through the accounts at the end of the year.

  Pay it, ideally through the **bank** rather than cash so that it's easy to prove it's been paid and record it in your accounting records.

- Comply with any **PAYE procedures** as you would do for normal staff. Remember, it may also help keep up their National Insurance contribution record even if they don't pay any National Insurance on the salary.

How To Make Your Spouse/Civil Partner A Partner Or Shareholder In Your Business To Reduce your Tax Bill

We're now going to look at what has been a very **topical** piece of tax planning over recent years.

The basic idea is that income that was going to be taxed on you is now shifted to your spouse/civil partner who pays lower rates of tax.

You may have non-tax reasons for not wanting to do this as our cartoon above suggests even though in the event of divorce your spouse may well be entitled to half anyway, but let's get onto the tax savings…

- Firstly, it may simply be an alternative way of using their **personal allowance** rather than going down the road of paying a salary.

- However, this strategy is normally saved for situations where you are paying **higher rate tax** and you want to avoid this by splitting your profits or dividend income with your wife to use up her basic rate band as well.

> For example, if you earn £80,270 per year, then £50,270 is taxed at basic rates but the remaining £30,000 of this is taxed at 40%. So by it going to your spouse/civil partner, you could save £30,000 x 20% = £6,000 in addition to the saving on their personal allowance. This is tax saved **every year**. Over ten years, you're talking savings of £60,000, so it's worth a bit of further investigation.

The major obstacle that HMRC have tried to put in the way of this is what is known as the **"settlements legislation".**

In a nutshell this says if you give something to your spouse/civil partner that is **not** wholly or substantially a right to income, any income that does arise will be treated as their income for tax purposes.

However, after a long running battle in a well known tax case known as Arctic Systems it is at present law that if you give your wife some ordinary shares in your company or perhaps a share in your partnership, this is not just a right to income but it also contains **capital** rights, as by owning the share they become entitled to a proportion of the assets when the business is closed down and have voting rights. Therefore the share is not just a right to income.

The actual facts of this case that was finally won by the taxpayer at the House of Lords and cannot now be appealed are as follows…

> Mr Jones set up Arctic Systems in 1992 through which to offer his services as an IT contractor. He was the only director and held one of the two ordinary shares issued by the company. Mrs Jones purchased the other ordinary share from the company formation agents, and also became the company secretary.
>
> They acted on advice from their accountant to take minimal salaries from the company, and pay out most

of excess profits as dividends. As Mr and Mrs Jones held the shares equally, the dividends were paid to them equally and were mostly covered by their basic rate tax bands, meaning little higher rate tax was paid. If Mr Jones had paid himself a higher salary, or had been the only person receiving a dividend, he would have paid far more tax as much of his income would then have been taxed at the higher tax rate of 40%.

This type of arrangement has been standard tax planning for many husband and wife companies since the introduction of independent taxation for spouses in 1990. It was even recommended on the Business Link website! However, the Taxman decided to attack the arrangement, saying Mrs Jones only received her share, and the dividends paid on that share, because of Mr Jones work and the decisions he took as a director. The argument was that Mr Jones had effectively made a gift of half the earning capacity of the company to Mrs Jones, and because she is his spouse, the tax law says he automatically benefits from the gift, and thus Mr Jones should be taxed on all of the dividends.

The House of Lords actually agreed with the Taxman that the shareholdings in the company had been set up to minimise the tax paid by Mr and Mrs Jones. However, because the gift by Mr Jones had been made to his wife, and the gift was not restricted to the earning capacity of the company, but included future rights to capital on liquidation, and the voting rights associated with the ordinary share, there was a get-out clause. This get-out clause only applies to married couples and civil partnerships, and says that if you make a gift to your spouse/civil partner (which comprises more than just income), and there are no strings attached, you should not be taxed on the income arising from that gift.

Mr Jones had allowed Mrs Jones to buy half of the company (the other ordinary share) for a very small sum. This did amount to a gift, but the gift was covered by what is known as the "spouse exemption", so Mr Jones could not be taxed on the dividends arising from Mrs Jones’ share. The Taxman went away red-faced, and the taxpayer was victorious!

For many years, accountants up and down the country have been using this so called loophole and the Arctic Systems case has clarified the law.

However The Taxman is a bad loser, and after a big defeat like Arctic Systems is now looking to change the law.

Income Shifting maybe Coming!

The day after the House of Lords judgement the Treasury minister under the previous Government said they would act against couples who indulge in income splitting in an unfair way.

The Government changed the description of this unacceptable behaviour to income shifting, defined as where one person diverts their income to a second person who is subject to tax at a lower rate, to obtain a tax advantage. Whilst nothing has happened yet, the 2007 Pre Budget Report indicated that new legislation to tackle income shifting will take effect from April 2008 but it has now been put on hold but being kept under review. If and when it does happen, it should only apply to income paid in the form of company dividends or partnership profits. Thus paying your spouse a fair salary for work done will not be attacked.

The exact details of how the income shifting rules will apply are open to debate, but the factors that may be taken into account include:

- The work done in the business by each individual;
- The amount of capital contributed to the business; and
- The business risks each person takes.

However, in light of the recession, the introduction of income shifting rules was postponed, to be kept under review.

So what can you do to improve your case in anticipation of the law being changed at some point?

The main problem can arise where the company is based on the work of just one of the married couple, such as a computer consultant. The spouse/civil partner doesn't work in the business and the company has no goodwill value without the computer consultant or any other assets to give it a capital value.

If your spouse/civil partner has become a shareholder or partner for legitimate reasons it will still be safe to do in future.

It is important that the gift of shares or partnership is an outright gift with no strings attached. Otherwise it will not count.

This can however be one of those grey areas mentioned earlier and you should get further advice from your accountant in your own situation as every case here will be different.

To help your case if the law is changed it means doing everything you would do as if this was a real commercial arrangement and not just because it is your spouse/civil partner. For example, having a partnership agreement, amending bank signatories, letterheads, telling suppliers, the VAT man, etc. If possible, also get your spouse/civil partner to introduce some money into the business.

We don't yet know how the new law will fully work but it is quite likely that by looking to put in place the following items you will help your case if the law is changed:

☐Avoid formal arrangements and contracts of employment.

☐Have no pre-arranged policy on salary levels or dividends.

☐Make both spouses/civil partners directors, and consider make your spouse the Chairman with the casting vote on the board of directors.

☐Maximise and document the efforts of the non fee-earning spouse/civil partner.

☐Consider an outright gift of shares to the non fee-earning spouse/civil partner before the business becomes profitable.

☐Tone down any description of your business activity in your accounts as being a “one man band” – but don’t be misleading. Create a more corporate image.

☐Avoid having different classes of shares particularly **non-ordinary shares** that have less capital value. You want ordinary shares in the company whose rights are not restricted in any way.

☐Make the share capital at least **£1000**.

☐Make sure all the **paperwork is right** and stacks up re Companies House forms, dividend resolutions, etc.

☐Consider <u>transferring assets to the company</u> in return for a new share issue to uplift the capital base of the company.

☐Don’t pay out all the profits in dividends. **Leaving about 20%** in the company increases the impression of capital rather than income.

☐Consider a **service agreement** for “one man” companies to secure the services of the leading light in order to lock in some goodwill value, therefore enhancing the capital value, but remember this may require the company to pay at least the national minimum wage to the main earner.

☐Ensure any dividends paid to a non-working spouse are paid into their **own** personal bank account.

- ☐Appoint the spouse as a director and company secretary and beef up their services as much as possible. Make them the **Chairman** with the casting vote.

- ☐Transfer the spouse's income if any into the company to increase their stake in the company.

- ☐Consider giving **more** than 50% control of the business to the spouse.

What About Using Other Relatives And Non Married Couples?

For non-married couples, and other relatives such as brothers, sisters or grandparents, the settlements legislation does not apply in the same way. The specific loophole applies only to spouses/civil partners.

However, if your relative buys a share in the business at the outset for a fair value it will work.

If you gift a share to a relative or live-in partner you should retain **no interest** in the gift, otherwise the income will still be assessed on you. This may be hard to substantiate where you and the person who receives the gift of the share are cohabiting and share bank accounts and living costs.

Giving Investments To Your Spouse/Civil Partner & Children

You should also look at your investments held by you and your spouse/civil partner to see if the total tax you pay on the income can be minimised. If you pay a higher rate of tax than your spouse/partner, you should consider transferring some income producing investments to your spouse/ partner to reduce higher rate tax you pay.

For any **jointly held** investments with your spouse (other than shares in the family company) they are treated as being owned 50/50 for tax purposes, however actually owned, unless you make an election to the contrary.

Any gifts to your **children** who are under the age of 18, which result in them receiving an income, will still be classified as your income for tax purposes apart from the **first £100** of income each year.

Section 7

VAT

“Read My Lips: No New Taxes”
George Bush 1988.

VAT was established as a new tax in 1973

Avoid Registering For VAT

When your taxable supplies of goods and services reach the compulsory turnover level for VAT registration, currently **£85,000** (from 1 April 2015) in any 12 month period, you have to register for VAT.

If you supply the **general public** this can be a major downside. You may not be able to increase your prices to them and so now instead of receiving £85,000, the VAT element of this (probably one sixth of gross sales) that is paid to you has to be paid over to HMRC. That’s over £17,000 of your takings now being lost.

However once VAT registered you can reclaim the VAT on anything you purchase, but if you supply a service, such as a hairdressing, your purchases are not likely to amount to much, so by growing your business you are worse off.

To overcome this, some people will try to **split** the business into 2 different businesses, perhaps husband and wife owning a bit each. Unfortunately there is specific legislation to stop this, so if you are going to do it, you need to set it up correctly.

> This is why for example, you sometimes get hairdressers renting a chair, so the hairdresser with that chair has the income rather than the shop and they pay a rent to the shop for the chair. Pubs sometimes try to do it with the food side being run by the wife and the wet drinks side by the husband, but it’s a dangerous game to be playing if it’s not set up correctly.

The businesses **must** be separate – it's no good sharing the same phone, having the same name, sharing the same employees, etc.

You would need to do everything that would happen if there really are two different businesses which is often easier said than done and may not be viable. If you get his wrong, you can be looking at substantial penalties, so take expert advice from your accountant.

Sometimes you may want to register for VAT, even if you don't have to. You are allowed to **voluntarily register** for VAT before you get to the compulsory VAT registration limit and it will often be worth businesses below the registration limit, doing so.…

> If you supply other businesses that are VAT registered, there is no problem as they don't mind being charged VAT on top from you because they can reclaim the VAT anyway. You can therefore increase your prices in this respect. You'll be better off because you can now also **reclaim** the VAT on everything you buy. You can also opt to use the **Flat Rate VAT** scheme and possibly make money out of it, (see below).

Use Cash Accounting For VAT To Help Your Cashflow

The normal basis for accounting for VAT on your VAT return is on an **invoice basis** so that you account for output VAT based on the invoices you have raised and reclaim input VAT based on the invoices you have received. This is irrespective of whether or not your sales invoices have been paid or you have paid your purchase invoices.

This means that assuming your outputs are higher than your inputs, you are paying over VAT to the VATman **before** it has been paid to you by your customers, which does not help your cash flow.

However, consider the **cash accounting scheme**…

- Cash accounting is a scheme whereby you can pay the VAT based on what you have actually received or paid. Businesses with a turnover of up to £1,350,000 can use the scheme.

- To take advantage of this you may need to adjust your accounting system so that it easily identifies all the outputs and inputs on a date received and paid basis. Many computerised packages allow you to change to cash accounting.

- To join the scheme you simply start using it from the start of your next accounting period, **no need to ask permission** from the VATman.

- Make sure you deal correctly with the sales where you have already accounted for the outputs on your last VAT return that are now received in the next VAT quarter. There is no need to pay the VAT twice and the same goes for inputs - you can't reclaim them twice.

There is also the **Annual Accounting Scheme** for VAT that allows businesses with a turnover of up to £1,350,000 to complete a VAT Return once a year, instead of quarterly to ease the admin. You can then pay your VAT on account for 9 months of the year and pay a balancing payment within 2 months of your year-end.

How The VAT Flat Rate Scheme Can Help The Admin & Save You Money

The **flat rate scheme for small businesses** is designed to simplify the completion of VAT returns for small businesses but it can also save you money. Do not confuse this scheme with the flat rate scheme for farmers, which is completely different.

What happens is that rather than calculate the output and input VAT due every quarter, you simply apply a **set percentag**e to your gross turnover (including the VAT charged to your customers) on a quarterly basis and this is the VAT due to HMRC.

To use the scheme your annual taxable supplies (excluding VAT) must be less than £150,000. Total income includes all income falling within UK VAT, which includes zero rated and exempt supplies such as letting a residential building, but not services supplied to customers outside the UK. If you want to exclude certain income from the Flat rate VAT scheme, such as let property income, you must ensure that income is received by a different legal person than that which is applying for the scheme. You must also not already use another special VAT scheme such as the second hand goods or tour operators scheme.

The fixed percentage that you apply depends on the particular trade sector that the majority of your business falls into. The percentages vary from 5% to 14.5%. The turnover to apply the percentage to includes all zero rated and exempt income.

To use the scheme you **need to apply** to HMRC.

If you buy any **capital assets** such as computers costing over £2000 each, you can apply to get the VAT back on these separately.

The scheme is designed to save on the administration costs of completing VAT returns, although you do still need to raise VAT invoices for your sales applying VAT at the normal VAT rate.

However it is also worth **calculating** how much VAT you would pay on this scheme compared to what you pay without the scheme to see if there is a VAT saving to be made by switching to this scheme. There is often a saving where you have a low value of purchases for your business sector, or make sales that fall into more than one trade sector.

So go check it out.

You Can Claim Back VAT On Fixed Mileage Rates Paid

When you pay a fixed mileage rate for business travel such as the **45p per mile,** this rate is intended to cover various elements such as fuel, repairs, insurance, depreciation, etc.

However you are allowed to reclaim the VAT on the **fuel** element, which many businesses forget to do.

To help you identify the fuel element the VATman has published advisory fuel only mileage rates for company cars. They are advisory rates, not compulsory but are a good starting point. To reclaim the VAT, simply multiply the fuel only rate by 20 and divide by 120.

If you have not reclaimed this VAT in the past, you can **go back 3 years** and reclaim the VAT now.

VAT Fuel Scale Charges – Calculate If You Want To Pay Them

If you reclaim VAT on fuel that is used for **private** purchases, you must pay a VAT scale charge based on the CO_2 emissions of the car. This is a fixed charge that is **not** related to the amount of actual use. £1 of private petrol and you're caught.

Scale charges are the most common omission form VAT returns and are one of the first things looked for on a VAT inspection and easy to identify when they are missing.

You should do a calculation to identify if it is worth your while reclaiming the VAT on private fuel. If the amount of VAT you can reclaim on the fuel you buy is less than the amount of VAT to pay on the scale charge then you can decide to **opt out** of reclaiming the VAT in order to avoid the scale charge.

If the company car driver repays you in full for any private fuel used, then no scale charges are due. However, you should charge output VAT on the amount the driver pays to you.

You can have some cars opt for scale charges and some not.

Do whatever’s best. It’s up to you.

Section 8

Tax Savings For Employees

Don't forget that this normally includes you if you have your own Limited Company and are a Director

Are Your Workers Self Employed or Employees

We're starting with this one because the amount of tax and penalties at stake can be **massive**.

The important point here is that it's not up to you or the worker to choose between employment and self-employment. Whether the worker is self-employed or not is judged on **circumstances** surrounding the particular job the worker is performing. Individuals may be self-employed for some contracts, and correctly treated as employees for other jobs. . If your workers can be considered to be self-employed there are enormous tax and other benefits to you and the worker.

Take a worker earning £30,000 (gross) a year from you. The Employers National Insurance alone comes to over £3,000 that wouldn't be paid if they were self-employed. The worker would also save on some NI and be able to claim some expenses against their tax bills that they can't as an employee.

> Also, by using self-employed workers, you don't have to worry about all the horrendous employment legislation: no holiday pay, sick pay, redundancy, national minimum wage, etc to worry about. These things could possibly be catered for through your self-employed worker having a higher rate of pay.

To get to this position you need to demonstrate that your workers are self employed and over the years various **tests** have been developed to determine someone's employment status.

The first question to ask is:

- Is the worker really running his own business?

Strong indications of this would include:

☐ Do they work for **other people or organisations** and not just for you?

☐Do they provide their own **materials**?

☐Do they invoice by reference to the job rather than **hours** worked?

☐Do they take the **financial risk** if they do the job wrong (eg. they could be sued for faults in the work)?

☐Do they correct **defective work** in their own time, at their own cost?

☐Have they got **public liability insurance**?

☐Do they use their own **equipment**?

☐Does the worker **advertise** his services elsewhere?

☐Is his business **registered** as self-employed business with HMRC?

☐Is the business VAT registered?

☐Does the worker have his own **business stationery**?

☐Do they work from their **own premises**?

☐Do they work at the **times** that suit them?

☐Are **invoices** raised for all work?

If it is not clear from answering these questions that you are dealing with an independently run business they you need to consider the following three key factors:

☐Can they send a **substitute worker** to do the work?

☐Do they have the option to **turn down work** offered and do you have the option not to offer work?

☐Do you have the right to **control** how they do the work?

If you can answer yes to these three questions the worker is almost certainly self-employed. But if it is still not clear look for factors that would show that the worker is part of your organisation and has the benefits that an employee would normally enjoy, such as:

☐**Holiday pay** & **sick pay.**

☐A **notice period** to end the arrangement.

- ☐Company type **benefits** such as the use of a corporate gym, car, or pension contributions.

- ☐A **long period** of working for you.

If in doubt, get some advice from your accountant.

If you feel the worker is self-employed, make sure they have a **contract** that demonstrates this. There are standard self employment contracts around but you should tailor these to match the reality of your own situation. Where there is a good written contract the Taxman is not entitled to look outside of the written terms unless he can show that it does not represent the actual circumstances of the working relationship.

If you get it **wrong**, the results can be disastrous. The Taxman may contend that what you paid to the worker was their net pay and so will want to gross it up to collect the tax and national insurance from you, not the worker. Imagine this going back six years and you are looking at **tens of thousands** of pounds.

What's the chance of you being able to recover it from your worker?

It's even worse if several of your workers are like this as is often the case. When businesses expand they often expand by replicating what they already have. Be careful to watch out for workers who start off being legitimately being self-employed doing the odd job who gradually progress to working only for you.

Also, just because the worker has a **self-employed tax reference** doesn't mean his work for you will be treated as self-employment.

The **construction industry** has been one that has been badly hit by the Taxman attacking their workers in this regard but other industries are also open to attack, so get it set up right in the first place.

People who run **personal service companies**, a lot of which are I.T. Contractors, may also be familiar with what is known as **IR35**. This is where a Limited Company is used to provide the services of an individual and if it weren't for the company being in place, the individual would really be treated as an employee. In these cases, the tax and NI ends up working in a similar way as if they were an employee, only it is the responsibility of the **worker** to deal with all the taxes. Although outside the scope of this report, similar arguments prevail regarding employment status as to whether this should be treated as such.

How To Pay Your Staff Tax Free By Using The Staff Suggestion Scheme

This scheme is specifically allowed and provided for in the legislation. It is very simple to operate and works as follows…

- Employees can be rewarded for making suggestions relating to improvement in efficiency or effectiveness and such payments can be made without **tax or NI** being payable. You get tax relief on the payment through your accounts, just as you do with paying normal salaries.

- There is a maximum limit of **£5,000** that can be paid if a suggestion is implemented and the benefits recorded.

- Payments of up to £25 can be made for employees' suggestions as an **encouragement**. Employees can make as many suggestions as they want.

- The suggestion must be **outside the scope** of the employees' normal duties, so a sales employee or director could suggest a production idea for example.

- The scheme must be formally set up but **no formal approval** is needed from HMRC.

- It must be **open to all** employees or a particular description of them and not part of their contractual entitlement.

- The amount to be paid must not exceed 50% of the expected net financial benefit to the business during the first year of implementing the suggestion, or 10% of the benefit over a 5 year period, whichever is the greater.

- There should **not** be formal suggestion meetings as this would make it part of the employees normal duties.

Make sure you keep some form of **record** showing how you calculated the expected benefit.

You can put a **simple one-page of rules** for the scheme up on your office wall that outlines all this and will constitute a formal scheme.

Apart from the tax savings, a suggestion scheme is a great way to help involve your employees in the business.

How To Use Long Service Awards To Get The Taxman To Contribute To Your Next Set of Golf Clubs

Long service awards made to employees and directors (that's you!) as testimonials to mark long service, which take the form of **tangible** articles of reasonable cost when you have worked for 20 years or more at the company can be given tax free.

Reasonable cost is taken to be **£50 for each year of service**.

So the purchase by the company of a set of golf clubs or anything tangible you want would be tax deductible for the company and not taxable on you.

Isn't it about time you got something back from the Taxman after all the tax you have paid over those 20 years. Not a lot, but still worth doing.

Other Benefits To Pay Your Employees Tax Free

By paying benefits tax free, it means your employees or you don’t have to pay for them personally out of money that has already been taxed.

Here’s a list of the main ones:

- **Crèches** - The crèche must be for the use of the employees’ children, sited on the company premises or premises of a group of employers.

  A crèche can be very expensive to set up and run, so as an alternative you can provide up to £55 per week of **childcare vouchers** completely free of tax and NI, although where an employee joins a scheme after 5 April 2011, the monetary equivalent of tax relief cannot be higher than for basic rate taxpayers. The vouchers must be made available to employees generally and only available to be used for registered childcare or approved home childcare. It’s important the cash is not paid to the employee in place of the voucher. If you want to set up a system for childcare vouchers try the website www.childcarevouchers.co.uk where you can also find out a lot more about it. You can also produce your own voucher for the employee to give to the childcare provider who in turn cashes them in with you.

  If you choose to provide vouchers and reduce the employee’s pay this is a **salary sacrifice** and needs to be **contractual** for it to be valid. Therefore, get their contract changed so that it’s not an optional item for them.

- **Uniforms** - they must have the company logo and be available to all employees or to all employees or a certain class.

- **Training** - the training must be related to a task the employee carries out as part of their job, or may have to carry out in the future.

- **Health-checks** - the provision of regular health checks is not taxable but the provision of health insurance, or medical treatment is.

- **Canteen meals** - this must be open to all employees.

- Low interest or interest free **loans to employees** of up to £10000 are OK.

- A **company bus** - with minimum seating for 9!

- Employer provided **bicycles and safety equipment** available to employees generally.

- There are **fixed mileage rates** that can be paid tax free to employees for using their own **bike** or motorcycle.

- There are set mileage rates that can be made tax-free to employees using their own **car** for business purposes tax-free. 45p per mile for the first 10,000 miles and 25p thereafter.

- **Annual Staff events** - if less than £150 spent per head per year.

- Provision of one **mobile phone per employee** – make sure the employer has contracted for the phone, not the employee.

- **Trivial gifts to employees** (not money) such as a turkey at Christmas. The gift must not be a reward for services as an employee. A seasonal goodwill gift is fine.

Putting £1 Of Petrol In Your Company Car Can Result In A Full Taxable Benefit In Kind

The **benefit in kind** that employees are taxed on if the employer pays for private fuel is based on applying the company car percentage related to the vehicle emissions to a figure of £24,600 which can produce a substantial tax charge. Please consider the following…

- If your **actual** fuel costs are below your **tax cost** you should look to scrap the provision of private fuel.

- The fuel scale charge can be proportionally reduced if the company stops providing fuel part way through the tax year. But if the company starts to provide fuel in the tax year the fuel scale charge for the whole tax year will apply, unless:

- the provision of fuel is formally withdrawn; or
- the fuel is only provided for business travel; or
- the employee is required to repay the company for all of the fuel provided in the company car that is used for private journeys.

So if you put **£1** of petrol early in the tax year, and do not repay that cost in you can get a tax bill for the entire tax year or until you no longer have the car.

☐Make sure you don't get caught out like this and **plan** what you are going to do before the tax year starts.

☐If you've already done it, **reimburse** the full cost to your company now. You must repay the company the full cost of the fuel within the same tax year that the fuel was provided, or you will be taxed on the fuel benefit for the entire tax year.

☐It is now almost always cheaper for employees to pay for their own fuel out of extra wages.

Avoid Settling Employees Personal Liabilities And Contract For Your Company To Pay Instead

Almost all **personal liabilities** that are paid for by the employer incur Class 1 employees and employers National Insurance.

Where the employer **contracts directly** to pay something for the benefit of the employee, then only Class 1A National insurance is normally payable by the employer.

For example, if personal fuel was provided under a company account or by using a company credit card this would cost less in national insurance than the employer reimbursing the employee for amounts they paid personally for fuel.

Paying Bonuses Half Yearly or Yearly Can Save On Employees National Insurance

National insurance for employees is payable on earnings that are between the earnings threshold and the **upper earnings limit.**

This means if bonuses are paid monthly, it is likely that for most employees all of their earnings will be between these two points and **all** of their bonus will attract national insurance.

However if bonuses are paid in larger lumps say either yearly or half yearly, a lot of this bonus may put the earnings for the month in which they are paid over the upper earnings limit and so will only attract employees national insurance at the additional 2% rate.

This does not apply to **directors** who have special rules for national insurance calculations.

Taking On A New Employee

You are responsible for deducting the correct amount of tax and NIC from the pay of all your employees. If a new employee arrives without a form P45 from a previous employer, get them to fill in a Starter Checklist from HMRC and keep a copy. This is evidence HMRC will accept that the amounts you have deducted for tax and National Insurance are correct.You won't be able to give your employee any personal allowances against his pay without following this procedure.

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Company Vans

There is no taxable benefit if the employee merely takes a business van home with no other significant private use allowed. However, where there is private use that is more than home to work travel, the taxable benefit is £3,500 irrespective of the age of the van.

There is also a fuel benefit for private fuel provided of £669.

These are significant increases on previous year benefits and so company van policies need reviewing. It helps to get a no private use agreement drawn up with the van driver.

Salary Sacrifice

It is ideal to provide benefits to employees that avoid an income tax charge and NI for both the employer and employee. To replace salary with benefits it is important to get the employee to sign a salary sacrifice letter before the reduced salary takes effect. The salary sacrifice means it is a permanent alteration to the employees contract and they do not have the option to revert back to their higher salary if they so wish. Otherwise the Taxman will argue they are taxable on the benefit as if it were salary.

Tax Free Gifts To Employees

Where there is a genuine gift in recognition of some personal quality of the employee, and is in no sense a reward for performing duties past, present or future, then it can be paid tax free. The gift could therefore be on personal grounds (such as a wedding present) or as a mark of personal esteem or appreciation. It is sensible to evidence such gifts with an appropriate covering letter.

Golden Hellos

A golden hello is when a lump sum is paid on taking up an employment. Tax is normally payable on such payments as if they were salary. However, if the payment is an inducement rather than a reward for future services, then it should be tax free if it satisfies the following conditions…

1. The facts must show it is an inducement to take up the new post and not a reward for future services.

2. The payment must not be refundable if the person does not take up the employment.

3. Case law shows it is more likely to be acceptable if the employee has previously been self-employed and has given up some right or asset to take up the employment.

This one is therefore not clear cut but is useable in the right circumstances.

Termination Payments – Tax Free to £30,000

When an employment contract is terminated (of an employee or director) it is possible that any termination payment of up to £30,000 can be made tax free. For the payment to escape tax there must not be any contractual requirement to make payment if full notice of the termination of the contract is not given. Ideally, the contract just has a notice period or at worse a clause that just gives the employer the right to make payment in lieu of notice (but not an obligation). So if the employer breaches the contract by not giving notice, any payment will be tax free up to £30,000.

You should evidence the termination payment with a letter to the employee explaining you are not making a payment in lieu of notice but have breached the employee's contract. Use a compromise agreement with the employee to ensure they do not bring further claims against you for breach of contract. The payment should be ex gratia and not as consideration for past services. Ideally the agreement to make the payment is made after the employment ceases.

Section 9

Pension Matters

"I have always paid income tax. I object only when it reaches a stage when I am threatened with having nothing left for my old age – which is due to start next Tuesday or Wednesday"
Noel Coward (Attrib.)

How To Invest £1260 In A Stakeholder Pension And Get A Pension Fund Of £2700

- ☐ If you invest £2880 into a registered pension scheme, the government makes a **tax contribution** of £720 for a basic rate taxpayer making your gross contribution £3600. A **40% rate** taxpayer can claim additional tax relief of £720 through their tax return.

- ☐ If you are over 55 and under 75, you could take a **tax free lump sum** from the pension fund of 25% x £3600 = £900.

- ☐ So as a higher rate taxpayer you invest £2880 less £720 less £900, a total of £1260 and now have a pension fund left of £3600 - £900 = £2700. Worth looking into a bit more!

How To Use Company Pension Contributions To Save On National Insurance

If you want to pay into a **personal pension** you simply make a net contribution of say £80 and the Taxman contributes £20 to give the pension fund a total of £100. Higher rate taxpayers can claim an extra 20% relief.

So how are you going to fund your pension contribution? You could pay it out of your net salary **after** tax and employees national insurance. Your employer would also have to pay employers NI on that salary. Alternatively you could pay the pension contribution out of your dividend or investment income which you will already have paid tax on.

However, if you are a director of your company, the company is your employer and it can pay pension contributions into a pension scheme on your behalf. You are not taxed on those pension contributions and the company does not pay national insurance on the contributions. The company thus saves national insurance by paying the pension contribution directly.

The **company will receive tax relief** on all the contributions paid as long as the total value of your remuneration package (salary + benefits + pension contributions), is reasonable in relation to the value of work you do for the company. Say you create £50,000 profits for your company, it could pay you a salary of £5,000 and make a pension contribution of £45,000, and still get tax relief on the total of £50,000.

Note that the company's contributions are not restricted by the level of your salary. It can pay any amount up to the annual allowance (£50,000 for 2013/14) into your pension scheme, as long as the 'reasonable' rule is followed.

The company should not pay more than the annual allowance into your pension scheme in one tax year, or you could be hit with a tax charge on the excess.

These pension rules make it even more attractive to run your business through a Limited Company, but you must ensure the pension policy is set up to allow the company to make **employers** contributions, and not pay your **employees** contributions.

Set Up A Pension For The Kids

You may feel it is a little early to set up a pension for the kids but the new pension rules do throw up a tax opportunity in this respect.

If you invest up to £2,880 net (£3,600 gross) per year there is no need to provide any proof of earnings. Any UK resident can pay into a pension even whether or not they have a job.

It is quite possible for a parent or other relative to start making pension contributions from the day the child is born. The fund then grows **tax-free**, but cannot be accessed until the child is aged 55. There are also certain inheritance tax advantages for grandparents.

A fund with contributions made up until the child is just 18 would grow substantially at even modest interest rates even if no more contributions were made after the age of 18.

Perhaps using this method and relying on growth between 18 and 55 is the way to fund pensions.

Using A Personal Pension To Buy The Company Premises

Your company may want to purchase its own freehold but doesn't have the money to do so. You could borrow the money but there is a way to buy the property and get a personal pension at the same time with its tax advantages.

The concept revolves around setting up a **Self Invested Personal Pension (SIPP)** that gives you control over your pension fund rather than an insurance company. This is how it works…

- ☐You can invest the pension fund in a range of investments including a **commercial** (not residential) property.

- ☐By contributing into your SIPP you get tax relief on your contributions at your top marginal rate.

- ☐The SIPP using these contributions can borrow against the fund value – but there are restrictions on the amount allowed.

- ☐It then **leases** the property at a market rent to your company, probably with the company responsible for repairs.

- ☐The company gets tax relief on the rental payment but the pension fund receives the rent tax-free.

- ☐When you finally retire, and the pension fund **sells** the property the gain on the property is tax-free because it is held in a pension fund.

- ☐As with any other personal pension you can take 25% of the fund as a **lump sum** tax-free. However by using a SIPP you do not have to invest in an annuity with an assurance company until you reach 75, meaning you can continue to retain control and self-invest.

If you have a **company**, you can alternatively look at having a small self-administered scheme (SSAS). Within certain restrictions, they allow loans to the company itself out of the pension scheme and they allow you to buy and leaseback the company premises. **Specialist advice** is essential for such schemes.

Section 10

Capital Gains Tax

The legislation is all about how not to pay it

Own Assets Jointly

If you make a £24,000 capital gain in this tax year, you will pay tax on £11,700 (£24,000 less the £12,300 annual exemption). If you had owned those same assets jointly, say with your spouse or partner, and they had no other capital gains this year, then you would pay no CGT.

Bed And Spousing

As the tax year comes to an end you may realise you have not used up your annual exemption of £12,300 for Capital Gains Tax purposes. You can't carry if forward to use in another year and so it's **wasted**.

You may have a large gain on an investment on paper, How can you use this to use up your allowance?

You may **not want to sell** the investment at present as you feel it is still sensible to hold onto it from an investment point of view.

With **shares** you could sell just enough to use up the annual exemption and hold onto the rest, doing a part disposal. Even then you've lost control of this part of the shares.

You used to be able to sell the shares through your broker and then buy them back immediately at the same prices, so called **bed & breakfasting** but the tax laws now have a **30 day rule** that prevents you from buying them back for 30 days if you want to make use of the annual exemption against that sale. By this time of course the price may have risen.

So what's the answer?

The answer is to bed and spouse. Let's explain…

- ☐You sell part of your shareholding to make a gain covered by your annual exemption.
- ☐Your **spouse/civil partner** rather than yourself, buys them back immediately.
- ☐ You need to watch out for anti avoidance laws so it would help it your spouse/partner buys the shares through a different broker and pays for the cost of the purchase out of their own bank account .
- ☐ This raises your spouse's base cost to decrease any future taxable gains on the shares.

Alternatives to Bed & Spousing are:

- ◆ Bed & Trust
- ◆ Bed & Company
- ◆ Bed & ISA

All these do pretty much what they say, with the Trust, Company or ISA (all controlled by you) buying the shares back on the open market.

Don't Get Clobbered For CGT When You Sell Your Business

The good news here is that for most businesses, if you've owned your business for more than 1 year, the first £1 million of qualifying lifetime gains since 11th March 2020 (was £10 million from 06th April 2011 to 10th March 2020) are only taxed at 10%, rather than 18% or 28%. This is as a result of what is known as **entrepreneurs' relief**.

The gain is primarily the difference between what you paid for your business or shares and what you sell them for.

Even then you can avoid paying the capital gains tax by reinvesting through **The Enterprise Investment Scheme or The Seed Enterprise Investment Scheme**, which are explained more a bit later.

One of the main conditions is that you must have owned the business for at least a year to get entrepreneurs' relief. If you have owned it for less than this it is seriously worth considering **holding on a bit longer**.

Also, you must be disposing of part or all of your business, and there are detailed rules on what part of a business' means. If you are selling a single asset, perhaps one field from your farm, entrepreneurs' relief won't apply.

The business must fall under the definition of a trading business, which means a property letting business will not qualify.

Where you are disposing of company shares you must have worked for, or have been a director or company secretary of that company, and have held at least 5% of the ordinary voting shares.

Do You Sell The Assets Of The Company Or The Shares When Selling Or Buying A Business?

When a Limited Company Business is being bought or sold there are often **conflicting** tax issues between the purchaser and the seller.

The choice is: are the assets within the company sold, or is the company sold as a whole by selling the company shares.

If the shares are sold, the purchaser takes over every asset and liability of the company lock, stock & barrel, but if just assets are sold, they only take over what is sold in the contract, usually leaving the liabilities behind.

The **purchaser will normally want the assets** as he then has no risk for any subsequent liabilities of the company that come out of the woodwork and he gets capital allowances on the assets. If the purchaser buys shares, he gets no immediate tax relief.

The **seller will normally prefer a share sale.** If he sells the assets out of the company the company will pay tax on the gain on the assets but the money will remain within the company. The owner of the company may have to pay tax on it again in getting it out.

Every case is a bit different, so if you are selling or buying a business take advice on which is going to best for you and negotiate for it.

Purchase Of Your Company's Own Shares

When no-one else wants to buy your company, this can be a way of getting your money out of the company tax efficiently. There are two main tax options.

- ☐ To have the buyback treated as a Capital Gain

  Or

- ☐ To have the payment taxed under Income Tax rules as if the money were received as a dividend.

Planning is critical as you will normally want the payment treated as a Capital Gain because of the availability of entrepreneurs' relief that reduces the tax rate to 10%. This should be discussed in detail with your accountant.

Roll Over Those Gains With Enterprise Investment Scheme Relief

Capital Gains Tax (CGT) can be substantial with gains made on items such as the sale of property or a business. However there are schemes that allow you to **defer or roll over** the tax payable on a capital gains so that no tax is payable immediately.

The Enterprise Investment Scheme (EIS) is one such scheme. This is how it works…

- ☐You need to **reinvest just the gain** you made (not the sale proceeds) into new shares in an unquoted trading company that issues EIS shares. This can be a company you run yourself, or run by a third party. If you do this, your CGT bill is deferred until you eventually sell the EIS shares.
.
- ☐The shares can actually be brought up to **one year before** you make the gain or **3 years afterwards**, so there is no urgency. In effect, by allowing one year before, it doesn't have to be the money you got form your sale that is used.

- ☐You must pay for the shares in **cash**

- ☐ The trade of the new company must be a **qualifying trade,** which means certain trades are barred such as those based on land, leasing or financial services. .

- ☐The company must continue its qualifying trade for a period of **3 years**.

One day when you will sell your shares, the original gain will crystallise and become payable, but you can control the timing of this tax charge to suit you. You also get the gain reduced by taper relief.

Alternatively, if you die owning the shares there is no CGT payable at all.

In addition, you receive **30% income tax relief** when investing in EIS shares, giving total tax relief of 58% for a 40% rate band taxpayer - not bad. To get the income tax relief there are a few more restrictions. You must not have more than 30% control of the company or be an employee or director when the shares are issued. Certain trades are excluded and the maximum investment is £2,000,000 per tax year.

The EIS tax reliefs are withdrawn if you don't hold the shares for 3 years**.**

Use a similar scheme for smaller companies- Seed Enterprise Investment Scheme Relief (SEIS)

Investment in smaller companies can also attract tax relief. For an investment of up to £100,000 per year you can achieve:

- Income tax relief at 50%
- Capital Gains Tax relief on shares held for 3 years or more
- Defer 50% of gains on amounts reinvested in SEIS shares.

How Becoming Non-Resident Helps Avoid Capital Gains Tax

When people sell their businesses or any assets on which there are large capital gains one of the more extreme steps they consider to avoid CGT is to **move abroad** and become non-resident in the UK.

Paying 28% tax on a £1,000,000 gain means £280,000 tax to be saved so may be it's worth considering. And it could be sunnier too.

You need to follow a few rules, the main ones of which are…

- You must take permanent residence abroad for **five complete years** including going abroad in the tax year before you sell.

- It helps if sell your **UK home** and get a new permanent one abroad.

- Don't come back to the UK too often, certainly no more than **90 days** on average in each of the five tax years.

- If you do become resident again in the five years, the gain becomes taxable.

Some countries will be more beneficial than others to go to but beware jumping out of the frying pan and into the fire of a country with an even worse regime for paying capital gains tax. **Choose a low tax haven**.

Going away may not seem so attractive if you can use entrepreneurs' relief. Is paying just 10% on your gain not a price worth paying to stay living in the UK?

Section 11

Other Personal Issues

"I believe we should all pay our tax bill with a smile. I tried but they wanted cash"
Anon

Always Make A Provisional Claim For Child Tax Credit & The Working Tax Credit

Working Tax Credit is mainly available to employees and the self employed who either

- ☐Do 24 hours or more paid work a week, are aged 16 or over and look after one or more children, OR

- ☐ Are 25 and over and work at least 30 hours per week.

Where relevant, the credit includes an amount for **childcare** whereby 70% of childcare costs of up to £175 per week can be claimed for one child or £300 per week for 2 or more children.

The basic credit is £2,005 per year plus a further £2,060 for a lone parent or where the claim is a joint claim.

However the WTC is reduced as the income from a single or joint claimant goes above £6,565 at the rate of 41p for every pound earned over this amount.

You qualify for **Child Tax Credit** if you are responsible for at least one child. The standard maximum amount is £545 per year, plus £2,845 per year for each child.

The important thing to note about tax credit claims is that they relate to your income of the **actual** tax year, which is **originally based** on your income of the **previous** tax year and then amended based on your actual when known. However, claims cannot be backdated more than three months and to be entitled to your 2021/22 credit you have to claim by 5th July 2022 to get your full entitlement.

The problem is you don't actually know your income for the year at this point so it always pays to make a **provisional claim**, even if your original assessment is Nil. It will then be backdated when your actual income is known but only if you made the provisional claim.

Variations in income of up to £5,000 between tax years are disregarded to help avoid having to repay tax credits already received.

The self-employed often have very different incomes from one year to another so it is especially important for them to make a provisional claim.

Tax Credits are really a social security **benefit** that happen to be administered by HMRC, they are not connected to the tax system, apart from the name, so some accountants deal with them and others don't.

Note: Universal Credit will replace Child Tax Credits and Working Tax Credits as well as income-based Jobseekers Allowance, Income Support and Housing Benefit. It does not replace Child Benefit.

Universal Credit is starting with certain areas of North-West England in April 2013. From October 2013 there is a national launch of Universal Credits for new claimants.

Buy To Let With An Interest Only Mortgage

When you buy a property to rent out, you often have a mortgage associated with the purchase. You get tax relief on the interest on this mortgage but not on the capital repayment element.

If you have a repayment mortgage, the interest element decreases over the term of the loan as more of the mortgage is repaid. Therefore the amount of interest you can offset against your rental income decreases and your tax bill rises.

The solution to this may be to take out an **interest only mortgage**...

- ☐ This means the repayments would be less each month and the mortgage would not reduce so the **interest remains high**.
- ☐ However, you don't want to be paying interest unnecessarily, so what you do with the saving on the lower mortgage payments is add these to the repayments on say your normal **home mortgage** and so repay this off quicker instead.

By doing this you can still pay off debt but by organising it this way, you ensure your tax on the rental income is minimised. What you are doing is paying less interest on your residential mortgage which is not tax deducible and more interest on your buy to let mortgage which is!

Rent A Room Out In Your House Tax Free

If you let out a furnished spare room in your own home, the first **£7,500** is received tax-free. These are the basic rules…

- This applies **per property**, not per person.
- This figure is for gross rents that include rent for accommodation, meals, cleaning and utility charges.
- If you exceed this limit then just the **excess** is taxed.

You should keep the name and contact details of the tenants to help justify where the income came from.

This scheme does not apply to companies but it does apply to lodgers who carry out their business at your home so long as they live there.

Letting out a room in your house does **not** affect your entitlement to Capital Gains Exemption on the sale of the house so long as you continue to live there when the room is let out.

Invest In Premium Bonds And Get Your Winnings Tax Free

If you invest in premium bonds all the prizes you receive are tax-free.

There is a limit of £50,000 (previous limit was £40,000)
you can invest but if you invest the full amount you are likely (but not guaranteed) to get a reasonable rate of return because of the amount of bonds you hold. Prizes are based on a rate of return of 1.0% at present.

Regular prizes should come your way and they are completely tax-free.

More importantly perhaps, there is also two opportunities of winning the **big prize** of £1 million each month.

Winnings on the **national lottery** are also tax-free but your chances of winning are far lower. If you win the lottery as part of a syndicate, make sure that you have a written agreement setting up how the group will be managed i.e. who buys the tickets and how prize winnings are to be shared out. Without such an agreement the person who collects the prize and shares it out may be considered to be making gifts for Inheritance Tax purposes.

National Savings also offer a number of tax-free investments.

Individual Savings Accounts

For 2021/22 the ISA limit will be £20,000 for shares and/or cash. The

investment in all types of ISA grows tax free.

Venture Capital Trusts

Investing in Venture Capital Trusts (VCTs) can also be used to obtain **30%** income tax relief. VCT's are quoted companies that hold at least 70% of their investments in shares in qualifying unquoted companies of the type that qualify for EIS.

They are therefore a **higher risk investment** but at 30% tax relief worth thinking about.

However, never invest in a business just for the tax relief. Better to lose 30% than 100% of your money!

Giving to Charity Tax Efficiently

When giving to charities through **Gift Aid**, you make your contribution net of basic rate tax, so the charity can reclaim this tax back from the Government.

If you are a **higher rate** taxpayer, you can then get relief for the higher rate tax on the donation through your tax return.

Section 12

Inheritance Tax Basics

"In this world nothing can be said to be certain, except death and taxes"
Benjamin Franklin,1789.

How right he was

Give It Away And Live For 7 Years

No inheritance tax is payable on most gifts in your **lifetime** so long as you live 7 years after the gift. These gifts are known as a Potentially Exempt Transfers (PET)

If a gift is made but there is some **reservation** on it, such as gifting your house with the understanding you can still live there until you die, this will not count as a PET and will still form part of your estate that is subject to IHT on your death. However, the gift will be effective for capital gains tax, which can create a double tax charge for the person that inherits the house.

If you give away cash that is used to purchase your house, you can be liable to income tax on the benefit of living in the house. This is called the pre-owned asset charge.

There is a sliding for scale for the amount of IHT payable for death within the 7 years.

Of course if your estate is worth less than £325,000, no IHT is ever payable.

Other Gifts That Are Always Free Of Inheritance Tax

The following will always be free on IHT, whenever they are made…

☐ **Small gifts** to the same person of not more than £250 in a year.

- Gifts in consideration of **marriage** of £5,000 from parents, £2,500 from grandparents and £1,000 from anyone else.

- **Normal expenditure out of income** where the amounts given are part of your normal expenditure taking one year with another.

- Amounts up to **£3,000**, with any unused amount being allowed to be carried forward to the following tax year.

- Capital transfers for **family maintenance** – often connected with divorce.

- Any gifts between **spouses/civil partners**, where the person who receives the gift is domiciled in the UK.

- Any gifts to **charities** or political parties.

Husband and Wife (or civil partners)

No inheritance tax is payable on gifts between spouses or civil partners as long as both parties are domiciled in the UK. This is often used as a basic method of IHT avoidance. If the gift is a transfer to a foreign domiciled spouse it is only exempt up to £55,000.

Spouses and civil partners can make full use of the nil rate band belonging to each spouse. This is retrospective and applies to anyone with a spouse or civil partner previously deceased. That gives a total inheritance tax exemption for a married couple of £650,000 (for 2021/22). The new rules allow any unused part of the nil rate band on the death of the first spouse or civil partner to be passed to the surviving spouse or civil partner for use on their death.

Say Fred dies on 1 October 2016 with an estate worth £650,000 and his wife did not use her nil rate band when she died previously, he now has the benefit of two nil rate bands totalling £650,000. Now Fred's executors will pay no IHT at all.

The amount of the nil rate band that can be transferred is the proportion of the nil rate band that was unused on the death of the first spouse or civil partner. For example if on the first death, 50% of a 325K nil rate band was unused, if on the second death the nil rate band is 350K at that time, then 50% x £350K = £175K is available for use in addition to their own nil rate band.

There is a maximum of an amount equal to the nil rate band in force at the time of the second death that can be used in addition. Therefore, it doesn't matter how many ex-spouses or civil partners there are, it is not possible to have a total nil rate band of over 650K in 2021/22.

Another point to bear in mind is that if 10% of the estate is given to charity, the IHT will be 36% instead of 40%. The 10% is a strict limit, even if the charitable donation made is 9% this will not count. The 10% limit is therefore a cliff edge so it may be beneficial to check any gifts to charities currently pledged.

Should You Leave Your Business To The Spouse/Civil Partner??????

Business Property Relief is available which gives up to **100% relief** from inheritance tax on death for business assets.

Therefore, it can help to leave your business to someone other than your spouse.

This is because what you leave to your spouse/civil partner is tax-free anyway. If you give them the business as well, this may increase their estate value so that **when they die** it is above their inheritance tax threshold.

By keeping hold of your business until death, it avoids any capital gain tax on the sale of it, as there is **no capital gains tax payable on any assets at all on death**.

Put Your Life Insurance Policy In Trust

When you take out life assurance, if the policy is written in trust for someone else, so that the life insurance payout goes directly to them, it avoids the payout becoming part of your estate for IHT and so avoids the 40% tax charge.

This is very simple to do and you should make sure all your life insurance policies are set up this way. All life insurance companies will have a simple form you can complete to arrange this, so review it now.

You will be able to change any **existing policies** if you need to.

Look Out For Any Capital Gains Problems If You Give Assets Away Now

If you are transferring assets other than cash to help with inheritance tax watch out for any potential capital gains problems on transferring assets between **connected persons**.

Connected persons cover most of your main relatives.

Transfers between connected persons are valued at **market value** for capital gains purposes and may give rise to a capital gain on which tax is payable. There is relief available for gifts of business assets.

What Can Be Done Once You're Dead?

It is possible for those entitled to your estate to vary the way in which it is distributed provided that they do so within 2 years of your death.

A **deed of variation** or disclaimer is used for these purposes, but all those who inherit under the will or intestacy must agree to the new arrangements.

Here is an example of how it could be used to advantage…

If an estate is left to the spouse/civil partner, this will increase their estate, so there may be IHT to pay when they die if they are already worth a lot. If they don't need what is left to them, the will could be varied, perhaps leaving the first £325,000 to the children on which there is no IHT to pay.

Section 13

Stamp Duty Land Tax

***"Death, Taxes & Childbirth!
There's never any convenient time
for any of them"***
Margaret Mitchell in Gone With The Wind 1936.

How To Minimise Stamp Duty On Property Transactions

Beware the stamp duty **thresholds** on buying a house. When you buy a house there is stamp duty land tax to pay depending on the price.

See if you can negotiate to have some of the price allocated to **fixtures and fittings** that do not count for the purposes of stamp duty.

The garden shed is also a wasting chattel and is excluded if you have some of the price allocated to it in the contract.

Section 14

Tax Investigations

Taxman: ***"The position is that if I don't have one thousand pounds from you soon, you're going to jail."***

Businessman: ***"Now you're talking. Here's one thousand pounds in used notes."***

Taxman: ***"Let me give you a receipt."***

Businessman: ***"What, a thousand nicker in cash and you're going to put it through the books?"***

Guardian

Understand The Type Of Enquiry You Have

Technically we now start with **enquiries** rather than **investigations** into your Tax Return. Let's start with the basic facts…

- ☐The enquiry may be an **aspect** enquiry into one aspect of your tax return or a **general** enquiry into the whole return.
- ☐Over 250,000 enquires are carried out every year and most are innocent enough affairs but if it leads to a full-blown investigation, it's not nice.
- ☐ The change to the self-assessment system has allowed HMRC to spend **more time** on enquiries and they have also put more and more resources into it.
- ☐Interestingly, most enquiries are into the affairs of men, rather than women.
- ☐HMRC are also becoming more business like, targeting the businesses where they are most likely to get a result.

- Whether they admit it or not, HMRC do have internal **targets** for the number of investigations to be carried out that are there to be met.

- HMRC may select you for enquiry for a reason or you may be chosen at **random** for a full enquiry.

- The problem is, they **don't tell** you whether you have been picked randomly or not, and they don't tell you what they already know. They often indicate they know something to make you confess to perhaps more than they know about.

- It all starts with a standard letter saying they are going to make an enquiry into your return and assuming you have an accountant, they will send a separate letter to them with the details of what their enquiries are. From this you can normally tell whether it is an aspect or general enquiry into the whole return.

- Aspect enquiries do have the potential to turn into full enquiries. A full enquiry will turn into an investigation when it spreads over into looking into your affairs for **more than one year**.

- With effect from 2007/08 onwards HMRC have one year after the date you file your tax return to enquire into it.

  After that you are safe unless they make a **discovery** of **fraudulent** or **negligent** behaviour. In these cases they can go back up to **20 years**, although **6 years** is the norm. It therefore helps to give them all relevant information when submitting your return to help ensure finality.

- Even your death isn't the end of the matter as the enquiry can still continue through your representatives. In war, your death is the end, but not so with tax.

What's At Stake?

As an example, let us say the Taxman finds just £1000 of income that hasn't been declared on a return, the tax on this could be £400.

If they can show this was **likely (not proven)** to have occurred for **6 years**, that tax bill becomes £2400. **Interest** will now be due on this, which could perhaps be another £1000.

In addition, there can be a **penalty** that can be <u>as much as the tax</u>. And in some situations from 1 April 2011 this can be up to 200% of the tax for those with financial interests outside the UK who have failed to declare the full extent of their offshore liabilities.

You are now looking at a tax bill of up to £5800, just because they found £1000 of income missing in one year.

Imagine how much you're looking at if £20,000 was missing from your accounts in a year.

Aspect enquiries often tend not to lead to fines and penalties but general enquiries are more likely to. **Jail** is always an option but very rare amongst small businesses and is reserved for cases of serious fraud.

Accountants are more likely to go to jail for tax evasion and no doubt lists of dodgy agents exist at local tax offices whose clients are therefore more prone to enquiry.

The problem with investigations is that the Inspector seems to have all the time in the world to go through your affairs with a fine tooth comb, to the extent of identifying what restaurants you eat in, where you go on holiday, etc. They do this to try to prove the income declared in your accounts cannot support your lifestyle. They may want detailed information going back years.

Can you…

- ☐ Remember why you didn't have any cash takings on the 3rd November 2001?

- ☐ Identify where a banking in your private bank account 6 years ago for £123.18 came from?

- ☐ Remember how much a week you spent on milk in 2002?

It's not out of the question that some tax inspectors will want to know the answers and be suspicious if you can't answer.

The taxpayer on the other hand has to pay an accountant and so time is often limited by **cost constraints** and even when you've done nothing wrong. It can end up being easier for some taxpayers to just give up the fight, particularly when the investigation has been going on for a couple of years.

Please note a full investigation can take **years**, not months to conclude.

Both the financial pressure and the pressure of just dealing with the investigation enquiries can be an enormous strain to taxpayers if they let it get on top of them. It's important not to panic or be pressurised into surrendering.

Also, did you know **accountancy expenses** in dealing with a tax investigation are **not** usually deductible as an expense against tax.

Sometimes it doesn't pay to own your own home, have savings, etc. There are some clients that just don't worry about a Tax Investigation and are happy to concede whatever the Taxman wants. Often, these are clients with **few assets** who know that whatever the Inspectors finds, they **can't pay**. If you haven't got the assets to pay, HMRC aren't going to be able to take anything from you. If this is the case with you, it helps to point this out at an early stage.

> Remember also, ignorance of the law is no excuse. As Lord Denning once said, "ignorance is a misfortune, not a privilege."

Why Do Enquiries Start?

A tax enquiry often starts because HMRC has some information on you. They try to select those cases where they feel there is a good chance of a successful outcome from their point of view.

They keep a file on you so that as much information as possible is kept in one place.

This means that they can review your affairs properly and it is often information from other sources that may lead to an investigation. So ensure you are properly prepared before meeting with the inspector as they have information from many sources…

☐**The Informers**
HMRC have a special hotline for informers to call as well as being able to report via the HMRC website and all informers can do so anonymously if they wish. There are many jealous neighbours, disgruntled customers, ex lovers and particularly **ex spouses** out there. Not all accusations are true but it could be the start of your enquiry.

☐**The Curious Inspector**
Part of the make up of being a tax inspector is to be naturally curious. How do their neighbours afford that expensive new car? They read local newspapers; scan the Internet, etc looking for anything that they can check against the information they hold on you.

If you're going to do a job cheaper for cash, you'd better hope, it's not for a tax inspector. Do you know what all your customers do for a living?

☐**From Other Taxpayer Enquiries**
Fred in the course of his investigation mentions that you lent him £15,000. The Taxman may want to discuss with you where you got this £15,000 from.

☐**Other Taxpayers Accounts**
For, example the inspector can request details of who commissions or rent in another taxpayer's accounts are paid to, in order to ensure they are declared by the recipient.

☐**Links With Customs & Excise & Government Departments**
The Revenue are now combined with Customs & Excise as well as having better links with other government departments. This also means that when your investigation finishes and you have undeclared cash takings, you are also likely to be clobbered by the VATman for the VAT due on them.

Even worse, if you weren't registered and your higher income now puts you over the VAT registration limit.

The **Collector of Taxes** may comment on the affluence of homes of people he visits and report payments in cash!

The **Stamp office** will report property transactions.

☐**Explanations On Your Tax Return**
Or rather, a lack of them. For owners of small businesses, enquiries often stem from their business accounts. The simplest way to avoid an investigation is to avoid an enquiry being made into your Return in the first place. The best way to do this is to explain anything unusual when your Tax Return is submitted rather than just sending it in without any explanations.

Your Tax Return is originally processed by a **computer** that carries out **analytical checks** on the figures to look for unusual items. If you know there is something unusual, explain it in the white space on your return, and then HMRC are far less likely to start an enquiry. It is crucial your accountant does this although often it doesn't seem to happen.

Examples of things you might explain:

- If profits or drawings are low, how have you lived?
- If you introduced some money into the business, where did it come from?
- If the gross profit margin has changed significantly, why is this?
- If any expenses are unusually high, why is this?
- If sales have fallen, why is this?

You are looking for anything that is unusual, looking particularly at what HMRC already knows about you from previous years.

Most of these will have simple explanations, so give them now and stop an enquiry being made.

Another reason for an enquiry could be that you haven't declared any interest being received in the year but HMRC knows you have an interest earning account. Is this where you have filtered away undeclared profits they wonder?

☐**Get It In On Time**
Sending Returns in late is also more likely to lead to an enquiry, so be organised. After all, if your Return goes in late it's an indication you are **disorganised** and so maybe your accounting records are a bit disorganised and may not be correct.

Random enquiries – a percentage of returns are also randomly selected for enquiry and there's nothing you can do to prevent these.

The Inspector's Job Is To Find The Correct Amount Of Tax Payable, Isn't It?

The Inspector will always tell you this at the start of an enquiry.

Often with investigations, **there isn't always a right and wrong answer**. In fact if you ask 10 different accountants to prepare you accounts, you'll get 10 different profit figures.

If in an investigation it was shown there were cash sales not declared or recorded, how do you get to the correct amount, particularly going back 6 years. The Inspector may present you with a financial model they have built up of you and your business to suggest the amount, but different models can arrive at different figures and the assumptions for each model may be in dispute.

Therefore, you often find that **tactical negotiations** between your accountant and the Inspector come into play. The Inspector has to abide by their own Charter for dealing with investigations. If they do something procedurally wrong, it gives you the opportunity to take the initiative and use it to your advantage in negotiations.

If you can't agree with the Inspector, the matter would normally end up being decided a Tax Tribunal, an informal independent tax court. Your accountant should never be afraid of taking your case to the tribunal. If the inspector has done something wrong, do they really want this information being brought to the attention of the tribunal? Everyone makes mistakes and if they have they'll often be more open to negotiation.

The **first tier tax tribunals** tend to hear most cases relating to small businesses. The hearings are in private and informal often held around a table. More complicated cases of a technical nature may go before the **upper tax tribunals** where they are tax experts and they are a more formal court.

Do You Use Your Existing Accountant?

Why you should…

- The existing accountant has **prepared the accounts** and has a lot of the detail already. This helps keep their fees down.

- They **feel bad** that the investigation arose from accounts they sent in, even though in reality it may well not be their fault. This could help in the fees that they charge.

However, with an investigation, you should be prepared to pay for the right help as it is a specialist type of service. Not getting the right help can be **extremely costly** given the amount of tax at stake. So possible reasons not to use your existing accountant are…

- Many accountants do not like dealing with investigation cases and some do. If you find an accountant who loves them, chances are he's the one for you.

- You want an accountant who is going to take the **initiative**, not just act as a middleman passing information backwards and forwards to the Tax Inspector. You can do this yourself without paying for it. Is your accountant the proactive type who will take the initiative?

- **You don't have to** use your existing accountant.

- You can change accountant at any time **during** an investigation.

    Just imagine a client being dealt with by a rather aggressive tax inspector. – not unheard of! The investigation could have been going on for 2 years, nearing its end with the client about to sign a contract settlement for around £200,000. This would probably ruin the client. Having run out of options, he may consult another accountant as a last desperate measure.

    Now imagine being the Tax Inspector on the other end of the phone, when they got the phone call informing them that the investigation they had spent two years on and were about to settle for a nice £200K had now been taken over by another accountant. That accountant wanted the inspector to copy every single paper and document that had been generated during the enquiry for review and the case was effectively being **starting again**.

    There is nothing to stop you doing this.

    It can often be helpful to resolve matters because the existing accountant and the Inspector can become so embroiled in the finer detail of the investigation, that they can't see the wood from the trees and get entrenched in their respective positions.

In the case of the client owing £200K, this was a real life case and various procedural and other errors were found. A meeting was arranged just with the tax inspector. 3 hours later there was a deal at around £80,000. Not a bad result and the client got to fight another day.

The Inspection Of Your Accounting Records

The Inspector will want to see all your accounting records. That includes bank statements, invoices, cheque stubs, paying in books, etc. It may also extend to items such as your work diary.

The issues revolving around this request are…

☐ You may prefer not to send them to the Inspector as this allows them to go through them at their leisure but ask for the to be inspected at your **accountant's office**. It's not normally recommended to have inspections at your own premises due to the opportunity offered to raise even more questions based on what the Inspector sees there.

☐ They are entitled to take **copies** of any documents and even take the originals away but you can argue you need them to run your business. The more they have to copy perhaps the less likely they are to take as many.

☐ Never, give them your records on **computer disc** as they have the technology to interrogate your computer records to raise even more questions. Always provide printouts.

☐ Never, make up **false invoices** or records retrospectively as they have the technology to date the ink.

☐ Many investigations arise when the Taxman doesn't fully understand your business and perhaps why you make the profit margins you do. As a result the Taxman may start an investigation and start with asking to see all of your business records. If you give them to him you give control to the Taxman.

You could instead start by offering to explain to him your business and how it works which may reduce the necessity for him to widen the investigation into looking at your records.

☐ They can only ask for information that is **reasonable** (fair & sensible) so don't let them overstep the mark. Sometimes, a request for private bank statements is reasonable and sometimes not, especially on the first request for records.

The reasons the inspector wants the **private bank statements** are:

◆ He is looking for **bankings** that haven't been taxed, particularly undeclared business takings. He is also on the look out for sales of assets he wasn't aware of and may want to know where you got the money from in the first place to buy them.

◆ He may ask you to prove that all the income on your tax return, such as dividends is banked in your personal account. If not, this may mean there is a second **undisclosed** account around he would like to see!

◆ He will also use your private bank statements to build a picture of the regular payments that go out of your account to get an idea of your **lifestyle** and see if you can afford it on the income you have declared. This information will then be used to catch you off guard at a meeting with him.

◆ If he sees no cash withdrawals out of the account he may be suspicious as he may take the view no one can live without cash. However, you can get cashback in many shops these days on debit cards, state benefits could be paid to you in cash, or perhaps older children with jobs or your spouse have their own accounts that cash is got from for family use.

It is normally best to let the Inspector see the records **first** before meeting them otherwise you often end up with the Inspector wanting another meeting after they have gone through the records. Better to get it all sorted in one meeting if possible. That's if you are going to have a meeting at all…

Meeting The Tax Inspector

Early on in an enquiry the Tax Inspector may want to meet with the taxpayer. It is **not compulsory** to attend but it can help to speed the investigation up and if you choose not to attend it may be seen as a lack of co-operation or suspicious by the Inspector.

Whether you go or not is a decision to be made on a case-by-case basis. Are you likely to help your cause by going, will you talk too much or lose your temper when interrogated for a couple of hours?

Whilst you do not have to attend a meeting, if the investigation ends with the Inspector finding additional tax liabilities on which **penalties** are due, the size of those penalties will depend on your level of co-operation and refusal to attend meetings may not help you here. Therefore, perhaps only if you are absolutely sure there is nothing for the inspector to find should you insist on not attending an interview?

If there isn't a meeting, everything has to be done by correspondence.

Let's find out a bit more about the meeting and how to handle it…

- ☐ If you do have a meeting, you should ask for an **agenda** and list of questions before attending so that you can prepare. You don't want the Inspector going on a fishing expedition into your affairs.

- ☐ This meeting is a prime time for the Inspector to find out all about you, your lifestyle and your business. It is one of the key moments so you need to be prepared for it. You should ideally have a **mock meeting** with your accountant first so you know what to expect. Only answer the questions, do not ramble. The more you talk, the more this is likely to lead to <u>never ending</u> questions.

- ☐ Open questions will be used to get you talking more than you should. A typical one may be **"Now Tell Me About Your Business"**. A reply something like, "What specifically would you like to know about my business?" may be the best response.

  Only try to answer specific questions and one item at a time. As they say, "give a guilty man enough rope & he'll often hang himself."

- ☐ **Don't** answer questions of detail that really need more consideration or are impossible to answer from memory. You can then reply to these in writing.

- ☐ If you feel more comfortable get the meeting at your **accountants office** rather than on the Inspectors turf. Don't be bullied into going to their premises if you don't want to.

- ☐ It's up to you if you offer them a **cup of tea**, but they are unlikely to offer you one if you go to them!

- ☐ Always have your accountant attend the meeting.

You will be sent **notes of the interview** to sign to confirm they correctly record the meeting – these may go to 20 or more pages. Never sign them at the meeting if asked to. Even subsequently, there is no legal obligation to sign them, especially as they may contain errors. It's best to get someone to take notes of the meeting on your behalf, or even video it!

Watch The Financial Models

The Inspector loves to present you with financial models, "proving" the undeclared profits.

Make sure you look at these models and the assumptions they are based on as the assumptions are often **open to debate**.

Also, ensure you check the **mathematical basis** for the model. This should be just the thing for your accountant.

One tax inspector presented a model that was supposed to prove the client had undeclared takings.

On the surface this model looked hard to defeat based on its assumptions. However, on closer inspection it was noticed the formulas used in the model were mathematically flawed. By using algebraic equations it was possible to prove the model didn't work and if corrected the result would be greatly in favour of the client.

On triumphantly showing this to the Tax Inspector, her response was she didn't understand algebraic equations and there was no way it could be wrong because she had been using it on clients for years. Can you imagine all the taxpayers who have been wronged by this?

She wasn't having any of it and as it revolved around the use of VAT in the formula, stated that the VAT department of HMRC should check it out. It was protested that this was ludicrous as the only thing you needed to know about VAT to get the formula correct was that it was 17.5% and that anybody in HMRC who understood maths would be able to tell her she was wrong.

Despite this she insisted on the matter going off and it took a further 3 months before she grudgingly conceded, but no sign of an apology. This later helped in the final negotiations.

How Else To Help Yourself

☐**Don't Be Funny**
A lack of sense of humour probably isn't a prerequisite for working for HMRC, but many Inspectors seem to lack one. Apologies to all those OK inspectors.

The client who wrote "F.All" in one box on his tax return regarding a question about income, did not amuse the Tax Inspector until he pointed out it meant "Family Allowance".

☐**Meet The Deadlines**
During the enquiry, the Inspector will expect you to reply and provide information by certain dates. Doing this can help with any final penalty you receive. Don't bury your head in the sand.

☐**Make A Payment On Account**
If you know the Inspector is going to find you've underpaid on your taxes, then make a payment on account early on. It will stop interest running.

☐**Don't Be Bullied**
Not all Tax Inspectors are the same and again apologies in advance to those that are always fair and reasonable, which many of them are.

However, you do get some Tax Inspectors who take the bullying approach to win. They have the full weight of HMRC behind them and they love using it. It's important not to let them get away with it and fight back.

You don't need to be aggressive in a personal manner but you do need to sometimes be aggressive **technically** by insisting on the rights that are enshrined in the legislation and by fighting on technical grounds wherever possible. Once you or more importantly your accountant does this, they will have more respect for you and are less likely to bully you again. HMRC would never like to admit it but it is far easier for them to pick on **weak accountants** without a great technical knowledge and natural human instinct may lead to this on their part.

Looking for errors that the Inspector has made procedurally is part of how to fight them. For example, they shouldn't just ask to see your **spouse's bank statements** without asking her permission. To do so is scandalous and yet Inspectors have been known to do it.

Dealing With The Penalties

At the end of an enquiry or investigation, there may well be penalties to deal with.

Firstly, there is **interest** to pay but HMRC see this as just financial compensation for them not having use of the money from when it should have been payable and so is largely fair and at a reasonable interest rate.

However, **penalties** are also due. There is a new penalty regime for return periods starting on or after 1 April 2009 or where the due filing date is on or after 1 April 2009. In fact the new penalty system replaces all penalties for incorrect returns which lead to an underpayment of tax for income tax, corporation tax, PAYE, National Insurance and VAT.

Penalties under the new legislation are based on the potential lost revenue. The starting point for the **maximum** penalty depends on the behaviour that gave rise to the inaccuracy.

For unintentional errors…

- Mistakes made despite taking reasonable care – no penalty.
- Mistakes made where there is a lack of reasonable care (i.e. carelessness) – maximum penalty is 30% of the potential lost revenue.

For deliberate inaccuracies….

- For deliberate mis-statements – maximum penalty is 70% of the potential lost revenue.
- For deliberate mis-statements which are then concealed – maximum penalty of 100% of the potential lost revenue.

So the starting point involves an assessment of the behaviour that gave rise to the penalty. And what is reasonable care will vary from taxpayer to taxpayer and is judged on the circumstances and abilities of the individual.

The maximum penalties can be reduced based on the disclosure made by the taxpayer to the taxman. Where a **disclosure is unprompted** in that it is made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy, the **minimum** penalties can be as follows…

- For careless errors – 0% (as opposed to 30%)
- For deliberate mis-statements – 20% (as opposed to 70%)
- For deliberate mis-statements which are then concealed – 30% (as opposed to 100%)

However where a disclosure is **prompted** as opposed to unprompted the minimum penalties are as follows…

- For careless errors – 15% (as opposed to 30%)
- For deliberate mis-statements – 35% (as opposed to 70%)
- For deliberate mis-statements which are then concealed – 50% (as opposed to 100%)

Please note that once an enquiry starts, it would be very rare for a disclosure to be unprompted if it is about something related to the enquiry.

How much the penalty is reduced from the maximum penalty to the minimum penalty is then based on the quality of the disclosure. The **quality factors** to consider are…

- Telling HMRC about it – up to 30% reduction
- Helping HMRC to quantify the inaccuracy – up to 40% reduction
- Giving HMRC access to the records to ensure inaccuracy is fully corrected – up to 30% reduction

So for example, someone with a prompted disclosure of a deliberate mis-statement with concealment can have the penalty reduced from 100% to

50%. If you score 25%, 15% and 30% on the above 3 items, this will give a 70% reduction of the 50% reduction which is 35%. i.e. the penalty will be 100% less 35% = 65%!

If the penalty arose because you failed to take reasonable care, HMRC can **suspend** the penalty for a period of time, a bit like a suspended sentence. As long as you behave during that time, the penalty will not then be payable.

The Old Penalties

Although the new regime is coming in based on return dates, there will still be penalties around under the old rules for some time. So these are summarised here.

The starting point is **100% of the tax** underpaid. That's an awful lot and another good reason to get your Tax Return right in the first place.

However, the penalties will be mitigated downwards according to certain factors as follows:

- Up to 40% discount relating to the amount of **tax at stake**.
- Up to 40% discount for the degree of **co-operation** of the taxpayer.
- Up to 20% discount for **voluntary disclosure** at an early stage.

In theory the penalty can go down to zero but this is rare. Something like a 10% to 30% penalty is more normal. If you disagree on the penalty, you can again make an appeal.

Claim Compensation From The Taxman When He's Out Of Order

You will not get compensation for everyday mistakes, at most an apology. Examples of this include errors in inputting tax return information, incorrect calculations, wrong penalty notices etc.

To get compensation you need **serious or persistent errors**. A serious error is something that no responsible person acting in good faith and with proper care could reasonably have done. Perhaps wrong advice from the Taxman that you relied upon.

A persistent error is one where the Taxman continued with the mistake after it had been pointed out to him or keeps making the same mistake or made several unconnected mistakes in the any twelve-month period.

The compensation you will get will cover putting the tax position back to where it should have been, reimbursement of expenses or financial loss and a consolatory payment.

Making a claim of this kind is a **customer service issue** and the Taxman will not hold it against you in any way.

Error Or Mistake Relief Claims

Although you normally only have one year after the filing deadline to amend your return, if you discover errors or mistakes that meant you overpaid tax going back up to 4 years, there are provisions within the legislation for making a claim for error or mistake relief.

These claims sometimes arise as a result of visiting earlier years during an investigation.

And Always

Don't panic, get a good accountant and let them take the pressure off of you.

Finally

The above gives you a flavour for some of what is possible with tax planning. If you would like us to help you save tax wherever you legally can, we would love to help you.