Ellacotts Tax Newsletter – April 2017

The new tax year starts on the day this newsletter is published, 6 April 2017. Philip Hammond has presented his spring budget and this month we are reviewing some of the issues he raised: Making Tax Digital, extension of the simplified cash basis for accounting, changes to Class 4 NICs and the reduction in the dividend allowance.

Our next newsletter will be published Thursday 4 May 2017.

Making Tax Digital

The current tax year, 2017-18, is the last year we have to prepare for the advent of the new reporting system, Making Tax Digital for Business (MTDfB). Following the recent budget, it is now clear which businesses are going to be affected and when. Dates for implementation will be:

- From April 2018, unincorporated businesses (including landlords) with gross income (turnover) above the VAT registration threshold (£85,000 for 2017-18) will be required to comply with the quarterly upload of summarised accounts data to HMRC.
- From April 2019, unincorporated businesses (including landlords) with gross income (turnover) below the VAT registration threshold (£85,000 for 2017-18), but above £10,000, will be required to comply with the quarterly upload of summarised accounts data to HMRC.
- From April 2019, filing for VAT purposes will also be bought within the scope of MTDfB uploads which will replace the current, quarterly VAT returns.
- From April 2020, filing for Corporation Tax purposes will be bought within the scope of MTDfB uploads.

In spite of intense lobbying by accountancy organisations and other small business groups, HMRC will require all businesses with taxable income in excess of £10,000 to comply with the upload of summarised accounts data when MTDfB applies as set out above. It was hoped that this exemption limit would be higher.

There we have it. The digitisation of tax reporting is well and truly underway – the most significant change since the introduction of Self Assessment almost twenty years ago. Initially, we would request that unincorporated businesses required to register from April 2018 ensure that their chosen method of recording their business accounts transactions will be MTD compliant. We are working with our suppliers of accounts and tax software and would be happy to assist.

Simplified cash basis

For some time now, unincorporated businesses have been able to submit simplified accounts in order to settle their tax liabilities. The main advantage of using this system is that income and expenditure is based on money received from customers and money paid to suppliers. In other words, the accruals basis, where income and outgoings are based on the value of invoices sent and received, is not applied.

Prior to 6 April 2017, the turnover threshold for the scheme was set at the VAT registration limit, £83,000 for 2016-17. In the budget this limit was increased to £150,000.

Adopting the cash basis does simplify the recording of transactions, but there are disadvantages and complications. For example:

- It is not possible to carry losses, accounted for using the cash basis, against previous year's earnings or sideways against other income in which the loss was made. Losses can only be carried forwards.

- It is not clear how VAT registered businesses using the simplified cash scheme for accounts purposes, will prepare VAT returns from April 2017. Certainly, they would be eligible to use the separate Cash Accounting Scheme for VAT purposes and this may be the best solution.
- Interest costs are restricted to a maximum £500 per annum rather than the actual amount paid.
- Cash basis accounts do not give a true picture of business performance and this can be problematic for supporting loan applications.
- Flexibility in varying claims for capital allowances is lost, this can lead to wasted personal allowances in certain circumstances.

The use of the simplified cash basis does imply a saving in the time taken to record transactions for tax purposes, but as we have set out above there are possible complications and significant drawbacks.

Class 4 NICs

The Chancellor announced two increases in Class 4 NI contributions for the self-employed in his budget and in the following week withdrew the increases for the term of the current parliament.

His original notion was to start the process of equalising the NI contributions made by the employed and self-employed now that State Benefits, particularly the new flat-rate State Pension, are available to both groups.

The first rate increase, from April 2018, was set to coincide with the abolition of the self-employed Class 2 contributions on this date. However, it would appear that manifesto promises carry more weight than fiscal necessity and the increases have been abandoned.

Class 2 contributions are still being withdrawn, which means that the scope of Class 4 contributions will need to be adjusted to counter any loss in benefits presently provided by Class 2.

Legislation in this area has been thrown wide open to change by the apparent U-turn since the budget announcements. As and when the intentions of government become more certain we will update readers accordingly.

Dividend tax set-back

The final matter we want to showcase for this month is the proposed reduction in the dividend allowance from April 2018. At present, shareholders with dividend income below £5,000 will pay no Income Tax on their dividend income. From April 2018, Mr Hammond looks set to reduce this to £2,000.

The average dividend yield for FTSE 100 shares is anticipated to fall to 3%. Based on this rate of return, investors would need a portfolio amounting to some £167,000 to create an annual dividend income of £5,000. From April 2018, only £67,000 would create tax-free income if the allowance drops to £2,000.

Affected investors should therefore consider other tax advantages options, including ISAs. From April 2017 the ISA limit is creased to £20,000.

Shareholders of non-listed private companies will face a tax increase due to this change. The present advantage posed by the low salary high dividend approach to profit extraction will still apply, but the overall Income Tax due will increase from April 2018.

Combined with changes to the taxation of benefits in kind, shareholder directors of smaller companies would be advised to revisit tax planning options for 2018-19.

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Tax Diary April/May 2017

1 April 2017 - Due date for Corporation Tax due for the year ended 30 June 2016.

19 April 2017 - PAYE and NIC deductions due for month ended 5 April 2017. (If you pay your tax electronically the due date is 22 April 2017)

19 April 2017 - Filing deadline for the CIS300 monthly return for the month ended 5 April 2017.

19 April 2017 - CIS tax deducted for the month ended 5 April 2017 is payable by today.

1 May 2017 - Due date for Corporation Tax due for the year ended 30 July 2016.

19 May 2017 - PAYE and NIC deductions due for month ended 5 May 2017. (If you pay your tax electronically the due date is 22 May 2017)

19 May 2017 - Filing deadline for the CIS300 monthly return for the month ended 5 May 2017.

19 May 2017 - CIS tax deducted for the month ended 5 May 2017 is payable by today.

31 May 2017 - Ensure all employees have been given their P60s for the 2016-17 tax year.