Ellacotts Tax Newsletter – July 2017

Our newsletter this month includes: now the election is over what happens next in the Making Tax Digital saga, a discussion of the combined Income Tax and NIC payments facing the self-employed, tax changes for landlords and a recent tax case involving fines.

Our next newsletter will be published on Thursday 3 August 2017.

Self-employed combined liability

Whether you pay Income Tax or National Insurance, the effect on your cash flow is the same. The payments are a necessary part of our obligation to fund the activities of State, but the self-employed are often surprised that their bi-annual tax payments cover Income Tax and National Insurance.

The weekly Class 2 contribution is included, presently £2.85 per week, and also Class 4 contributions: these amount to 9% of taxable income in excess of £8,164 and up to £45,000, and 2% on earnings above £45,000.

Accordingly, the combined rate of State dues on self-employed earnings in excess of £8,164 is potentially 29% - 20% basic income plus 9% Class 4 NIC – and over £45,000 a combined rate of 42%. Although in practice some of the income over £8,164 may be covered by other personal tax allowances, these combined rates illustrate the true impact of Income Tax and National Insurance to be paid.

The lower Class 2 contribution is due to be withdrawn from April 2018.

In his first stab at a budget in March this year, Philip Hammond wanted to increase the Class 4 NIC rates from 9% to 10% (April 2018) and from 10% to 11% (April 2019). These increases were subsequently withdrawn. Whether the new, minority government will seek to re-introduce these changes remains to be seen.

Self-employed traders with significant taxable earnings should therefore expect to pay more than the usual rates of Income Tax when they contemplate settlement of their annual Self Assessment bill, and have funds in reserve to meet these combined liabilities.

Landlords bear the brunt of recent tax changes

Recent budgets have done little to improve the financial position of landlords. One change stands out above the rest: the loss of higher rate tax relief on finance charges.

Many landlords have concentrated on growing their property portfolios in recent years and, taking advantage of the low interest rates, have borrowed heavily to maximise property acquisitions. In accountant speak, they are highly geared.

This strategy will come back and haunt many followers of this path as the tax relief for loan interest starts to reduce in the coming years. The changes will be:

- From April 2017, 25% of finance charges will be disallowed and replaced with a basic rate tax credit.
- From April 2018, 50% of finance charges will be disallowed and replaced with a basic rate tax credit.
- From April 2019, 75% of finance charges will be disallowed and replaced with a basic rate tax credit.
- From April 2020, only a basic rate tax credit will apply.

Landlords who only pay basic rate (20%) Income Tax on their property business may think these changes will have no effect on their tax bills, after all, the reduction in the deduction in finance charges is matched by a basic rate tax credit, but they may be mistaken. It all depends on the amount of loan or mortgage interest payments they presently pay and claim against their tax. Consider the following example:

Jo, whose rents for 2016-17 are £100,000 and loan interest is £80,000, will have taxable profits for the year of £20,000. Once the finance costs are fully disallowed, Jo's taxable income will be £100,000 (not £20,000), Income Tax will be calculated accordingly and much will be taxed at higher rates. She will be able to deduct a tax credit, based on finance charges disallowed, but only at basic rate Income Tax.

If rental profits were her only income, and with no increase or decrease in her rental income and costs, Jo's tax bill would increase from £1,800 for 2016-17, to £11,500 by the year 2020-21.

This sort of outcome would be disastrous for many landlords in a similar situation. They may be faced with selling property to reduce "leverage" and restore some sense of cash flow sanity to their tax affairs.

Clearly, there is a need to re-examine your investment strategy if your property business is similar to the above example. We can help. There may be possible changes you could make short of outright disposal. The key is to consider your options now.

Read more about how landlords are affected.

Making Tax Digital - are we making progress

There is evidence that HMRC's Making Tax Digital (MTD) implementation team are working with advisors and their clients to beta test the computer systems that will drive the quarterly upload process when it is timed to begin April 2018.

For those readers who may have missed our previous updates on this topic, MTD aims to have taxpayers' income and other relevant details uploaded to a personal digital account. When completed, this new system will eventually remove the necessity of a formal tax return each year.

Banks, employers, pension providers and business owners (including landlords) will have an obligation to upload data to HMRC. The information gathered will allow for the estimation of future tax liabilities in real time.

For business owners and landlords this is quite a change from the present annual tax return. At various implementation dates they will be required to make quarterly, summarised uploads of their accounts data and undertake an annual online check.

At present, HMRC is not providing direct access to taxpayers to comply with their MTD obligations; instead, business owners will need to use accounting or other software that is authorised for this purpose.

The present timetable, when businesses will need to start uploading data, is:

- April 2018 – the self-employed, including landlords, with turnover in excess of the VAT registration threshold, presently £85,000.
- April 2019 – the self-employed, including landlords, with turnover below the VAT registration threshold.
- April 2019 – submission of VAT returns
- April 2020 – companies and other organisations subject to Corporation Tax.

Businesses with income below £10,000 will be excluded from the MTD quarterly upload processes.

Incredibly, the legislation setting out the rules and regulations for MTD has still not reached the statute books. It was included in the Finance Bill 2017, but the relevant sections and schedules dealing with MTD were deferred for consideration until after the recent election. Professional advisors, software providers, and the business community looks forward to some progress in this area. Presumably, the deferred legislation

will reappear in a summer Finance Bill. The intention, we would assume, is to tidy up these loose ends before members of parliament break for their summer recess.

Read more about Making Tax Digital.

McLaren racing team lose tax appeal

It is a well-established feature of previous judgements that a fine imposed to punish an organisation should not be treated as tax deductible – the tax relief secured would effectively share out the burden of the punishment with the rest of the taxpaying community.

Which is why the First Tier Tribunal (FTT) decision, allowing McLaren racing to deduct a £32m fine for being in possession of documents belonging to Ferrari, was seemingly out of step with this point of view.

HMRC appealed the FTT ruling and the Upper Tribunal reversed the decision.

In some respects, this addresses issues of common sense as well as the law. If the FTT ruling had held, would we have seen footballers claiming tax relief on fines for bad behaviour? Or tennis players for swearing?

Tax Diary July/August 2017

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

6 July 2017 - Complete and submit forms P11D return of benefits and expenses and P11D(b) return of Class 1A NICs.

19 July 2017 - Pay Class 1A NICs (by the 22 July 2017 if paid electronically).

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

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

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

1 August 2017 - Due date for Corporation Tax due for the year ended 31 October 2016.

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

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

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