Ellacotts Tax Newsletter – July 2018

Our newsletter this month includes: changes to VAT in the construction sector, an update on the government's Making Tax Digital roll-out, commentary on self-employed tax liabilities and the setting of salary levels for directors.

Our next newsletter will be published on Thursday, 2nd August 2018.

Self-employed tax bills

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 both "taxes" – NIC and Income Tax.

The weekly NIC Class 2 contribution is included, presently £2.95 per week, also Class 4 contributions: these amount to 9% of taxable income in excess of £8,424 and up to £46,350, and 2% on earnings above £46,350.

Accordingly, the combined rate of State dues on self-employed earnings in excess of £8,424 is potentially 29% - 20% basic income plus 9% Class 4 NIC – and over £46,350 a combined rate of 42%. Although in practice some of the income over £8,424 may be covered by other personal tax allowances, these combined rates illustrate the true impact of Income Tax and National Insurance to be paid.

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.

Director minimum salary levels 2018-19

Many director shareholders take a minimum salary and any balance of remuneration as dividends. This tends to reduce National Insurance Contributions (NIC), and in some cases Income Tax.

The planning strategy is to pay a salary at a level that qualifies the director for state benefits, including the state pension, but does not involve payment of any NIC contributions.

For 2018/19 the NIC rate is set at 0% for annual earnings in the range of £6,032 to £8,424 inclusive. Earnings in this band range qualify for NIC credit for state benefit purposes. At up to £116 per week (£6,032 p.a.) no NIC credit is obtained for state benefit purposes. At over £162.01 per week (£8,424 p.a.) employees' NIC starts to be paid at the rate of 12%.

Directors, who are first appointed during a tax year, are only entitled to a pro rata annual earnings band that depends on the actual date appointed. Care needs to be taken in these circumstances not to incur an unexpected liability to pay NIC.

Directors resigning during the year still have the full annual earnings band quoted above, and so care is needed to ensure that earnings for the whole tax year are within the range of £6,032 to £8,424.

Careful planning is also required to ensure that any impact of the National Living Wage regulations is considered, this may be particularly important for women who would like to claim statutory maternity benefit at some future date.

Directors considering their planning options for the first time are advised to take professional advice when setting the most tax/NIC efficient salary. We, of course, would be delighted to help.

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Construction drawn into VAT reverse charge process

It would seem, that HMRC is keen to plug the apparent drain from VAT receipts when contractors and sub-contractors charge their customers VAT and then go missing, keeping the VAT for themselves. This is described in legislation as “missing trader fraud”.

Their preferred method for dealing with this abuse is to make customers responsible for accounting for the relevant VAT charge rather than the supplier of construction services. This is an extension to the reach of the “reverse charge” scheme.

It has been used in the past to tackle similar VAT avoidance tactics. For example, a reverse charge was introduced for:

- mobile telephones and computer chips with effect from 1st June 2007
- emissions allowances with effect from 1st November 2010

Further reverse charge measures were introduced for gas and electricity with effect from 1st July 2014 and for electronic communications with effect from 1st February 2016.

The government are considering this extension of the reverse charge process to the construction sector from 1 October 2019.

According to HMRC:

The risk of fraud in the construction industry is principally centred around the supply of construction services between construction businesses in the supply chain and this instrument, therefore, does not require other types of business to apply the reverse charge when receiving construction services and there is also no reverse charge requirement in relation to building and construction materials that are supplied separately and independently of construction services.

They conclude:

Reverse charge accounting makes it impossible for fraudsters to perpetrate missing trader fraud because the customer rather than the supplier accounts for the VAT direct to HMRC. The introduction of the reverse charge in this business sector will mean that businesses will need to adapt their systems and manage their cash flow differently. Due to the large number of small businesses potentially affected by a reverse charge for construction services the government has given a long lead-in time to help businesses adjust, having announced in Autumn 2017 the intention to introduce legislation which will come into force in Autumn 2019.

Making Tax Digital

A reminder that from April 2019, HMRC’s much vaunted Making Tax Digital (MTD) scheme will apply to certain businesses.

The April 2019 launch will only apply to VAT registered traders. More specifically, MTD will apply to businesses who have a turnover above the VAT threshold - the smallest businesses will not be required to use the system, although they can choose to do so voluntarily.

Live pilot studies are already being carried out and the first businesses have started keeping digital records and providing updates to HMRC to test and develop the MTD service for income tax and NICs. HMRC is keen to expand this pilot.

HMRC announced in 2017:

We will start to pilot Making Tax Digital for VAT starting with small-scale, private testing, followed by a wider, live pilot starting in Spring 2018. This will allow for well over a year of testing before any businesses are mandated to use the system. No business will be mandated before 2019.

From April 2019, businesses above the VAT threshold will be mandated to keep their records digitally and provide quarterly updates to HMRC for their VAT.

We will keep an eye on the results of the pilot studies and monitor the progress of accounting software providers to create the necessary links with HMRC's digital systems.

At Ellacotts, we offer cloud accounting software for record keeping, which reduces your costs, keeps all your finances together and allows you to work more efficiently.

We are Xero platinum partners and certified in the installation and operation of a range of cloud accounting software, which is digitally compliant and specifically designed for small and medium-sized businesses.

If you are registered for VAT, have an annual turnover above the current £85,000 limit, and have not yet considered how you are going to cope with MTD, please contact us so that we can help you research your options. Find out more about our Cloud Accounting Solutions

Tax Diary July/August 2018

1 July 2018 - Due date for corporation tax due for the year ended 30 September 2017.

6 July 2018 - Complete and submit forms P11D return of benefits and expenses and P11D(b) return of Class 1A NICs.

19 July 2018 - Pay Class 1A NICs (by the 22 July 2018 if paid electronically).

19 July 2018 - PAYE and NIC deductions due for month ended 5 July 2018. (If you pay your tax electronically the due date is 22 July 2018)

19 July 2018 - Filing deadline for the CIS300 monthly return for the month ended 5 July 2018.

19 July 2018 - CIS tax deducted for the month ended 5 July 2018 is payable by today.

31 July 2018 – Deadline for payment of second instalment self-assessment for 2017-18.

1 August 2018 - Due date for corporation tax due for the year ended 31 October 2017.

19 August 2018 - PAYE and NIC deductions due for month ended 5 August 2018. (If you pay your tax electronically the due date is 22 August 2018)

19 August 2018 - Filing deadline for the CIS300 monthly return for the month ended 5 August 2018.

19 August 2018 - CIS tax deducted for the month ended 5 August 2018 is payable by today.