All Paul Limited

CHARTERED CERTIFIED ACCOUNTANTS

November 2016

Helping smaller businesses and their owners manage their accounting, business and taxation

The Autumn Statement 2016

Tightening the rules for small businesses

A short guide written by All Paul Limited for our smaller Owner-Managed Business clients on the taxation effects

Introduction

The new Chancellor, Philip Hammond, delivered his 2016 Autumn Statement on 23 November 2016 and announced it will his first and last Autumn Statement, though this was more of play on words.

There will be two Budgets in 2017, the first being the usual Budget in Spring, and a second in the Autumn. Thereafter, there will only be one major tax announcement each year, in the Autumn. A Spring Statement will be made from 2018 onwards and Mr Hammond has confirmed that this is unlikely to contain major fiscal changes, unless particular matters need to be addressed prior to the

One of the reasons for this change is to allow Finance Bills to be introduced with sufficient time for Parliament to scrutinise any proposed tax changes and to reach Royal Assent during the following Spring and before the start of the new tax year.

For those of us with long memories, this is a return to the conservative government of the mid-nineties when Kenneth Clarke delivered his budgets in November, before Gordon Brown reverted to the traditional March date, and inflated the status of the Autumn Statement.

This guide focuses on the taxation aspects of the Autumn Statement only and is designed to appeal to our smaller business clients.

The following summary is based upon material made available on the gov.uk website following the Chancellor's statement

Personal tax

Income tax: Rates and allowances

As previously announced, the personal allowance is increased to £11,500, from £11,000, and the basic rate band extended to £45,000, which is currently £43,000, in 2017-18. The Government has confirmed its commitment to increase the allowance to £12,500 and increase the basic rate band to £50,000 by the end of the current parliament in 2020.

Benefits in kind

As announced in the 2016 Budget, legislation to be introduced in Finance Bill 2017 and having effect from April 2017 will allow an employee to make a payment in return for a benefit in kind and reduce the taxable value of the benefit as long as the payment is made by 6 July in the following tax year.

In addition, Finance Bill 2017 will include provisions intended to clarify existing legislation so that employees will only be taxed on business assets for the period the assets are made available for private use.

The Government intends to carry out a review of how benefits in kind are valued and will publish a consultation document on employer-provided living accommodation.

Property and trading income allowance

At March Budget 2016, the Government announced the introduction of a £1,000 allowance for property income, from 6 April 2017. The Budget notices indicated that individuals with property income below £1,000 in a tax year would no longer need to declare or pay tax on that income. Those with income above the allowance would be able to calculate their taxable profit either by deducting their expenses in the normal way or by deducting the allowance from their gross income.

The Government confirmed that this measure will be brought forward in Finance Bill 2017. A similar, but separate, allowance is confirmed in respect of trading income, which will now also apply to certain miscellaneous income from providing assets or services.

National Insurance

National insurance: Thresholds

The employee and employer thresholds will be aligned from April 2017 so that both employee and employer will start paying National Insurance contributions on weekly earnings above £157. Currently, there is a National Insurance free band of £155 before employee's National Insurance starts, but £156 before employer's National Insurance starts.

Whilst this is a simplification recommended by the Office of Tax Simplification, the government have stated that it will actually cost a business a maximum of £7.18 per employee per year. This will mean most director-shareholders in their own personal companies will see a small increase in their tax efficient salary increasing from £672 pm to £680 pm.

PAYE and Class 1 NIC

There has been a certain amount of speculation as to whether PAYE and Class 1 NIC could be aligned to simplify matters for employers, stimulated by the work done by the Office of Tax Simplification (OTS) on that topic. There were a couple of minor tweaks. However, the Chancellor stopped short of full reform to achieve full alignment between PAYE and Class 1 NIC which would have meant Class 1 NIC moving to an annual, cumulative and aggregate basis.

Currently, each employment is treated separately for National Insurance purpose and, unlike income tax, is not aggregated with other employment or self-employment income. This means that with a limit planning, and two or more companies or self-employments, that an individual can receive over £8,000 of income from each employment completely free i.e. 3 jobs results in £24,000 of income National Insurance free.

National Insurance: Termination payments

As announced in the 2016 Budget, from April 2018 termination payments in excess of £30,000 which are subject to tax will also be subject to employer NICs.

Abolition of Class 2 NIC

Clarification has been provided that the self-employed will access contributory benefits through Class 3 and Class 4 NICs following the abolition of Class 2 NICs from April 2018.

Those with income below the Small Profits Limit (£5,965 for 2016-17) will need to pay Class 3 NICs to access contributory Employment and Support Allowance, and support will be given to such individuals during the transition.

Currently Class 3 weekly rates are much higher (£14.10 pw) than Class 2 rates (£2.80 pw) so this will be an added cost. All self-employed women will still be able to access the standard rate of Maternity Allowance.

Making Tax Digital

The government has announced that it will publish its response to the 'Making Tax Digital' (MTD) consultations. It will also publish provisions to implement previously announced changes. MTD is the biggest change to the tax system ever; even bigger than the introduction of the Self-Assessment system in 1997.

The MTD consultations set out the Government's proposals for transforming the tax system to make it one of the most digitally advanced tax administrations in the world by 2020. The changes are set to be rolled out from April 2018 and among the issues addressed in the consultations were mandatory digital record keeping and the provision of quarterly updates by businesses, self-employed people and landlords. The consultations closed on 7 November 2016 and HMRC are currently reviewing the responses submitted.

Business tax

Incorporation

The Chancellor noted in his speech that the Office for Budget Responsibility has highlighted the growing cost to the Exchequer of incorporation as tax revenues are eroded.

The government will therefore be considering how to ensure that the taxation of different ways of working is fair between different individuals, and sustains the tax-base. They will consult in due course on any proposed changes.

Many of our smaller business clients trade as limited companies as this reduces their overall tax costs, mainly through avoiding the payment of Class 4 National Insurance of 9% that the self-employed must suffer. The new dividend tax, introduced from 6 April 2016, of 7.5% on profits withdrawn through dividends tax reduced the tax (well National Insurance) savings. Does this mean further tax on the smaller owner-managed limited company business?

Salary sacrifice schemes

A salary sacrifice arrangement is an agreement between an employer and an employee to change the terms of the employment contract to reduce the employee's entitlement their wages or salary, but instead the employee receives a non-cash benefit (in kind). Employee's National Insurance is not payable on benefits in kind and any income tax and employer's National Insurance is usually payable on the cost of the benefit. Without the benefit in kind a higher gross salary must be paid, with higher tax and National Insurance, which would then net down to enough for the employee to acquire the non-cash item. This reduces the tax cost to both employee and employer.

As widely predicted, measures will be introduced, taking effect from April 2017, to ensure that benefits provided as part of a salary sacrifice scheme will be treated the same as cash income. Pensions, pension advice, childcare, cycle to work schemes and ultra-low emission cars will be exempt from the new rules.

Any arrangements in place before April 2017 will be protected from the new rules for up to a year and arrangements involving cars, accommodation and school fees will be protected for up to four years.

Directors of small businesses, and their family members, often do not have formal contracts of employment so may not be affected by the changes.

Following on from the consultation held over the summer, the Chancellor confirmed that, from April 2017, salary sacrifice arrangements may only be used to achieve tax and NIC savings in the case of:

- employer pension contributions and advice
- employer-provided childcare
- cycle to work schemes
- ultra-low emission company cars

For any other tax-exempt benefits, their exempt status will be lost if they are provided in exchange for a salary sacrifice.

In the case of taxable benefits provided as part of a salary sacrifice arrangement, the law will be changed so that the employee is charged to tax on the higher of:

- the cash equivalent of the benefit as set out in the benefits code, or
- any amount of salary sacrificed in exchange for the benefit

It is worth noting that although the law will be changed as from 6 April 2017, any arrangements in place before that date can continue unaffected until 2018 (with a further extension until 2021 for existing longer term agreements covering cars, living accommodation and school fees). This means that employers should have sufficient time to renegotiate remuneration packages for affected employees.

Business tax (continued)

Corporation Tax: Rates

The Corporation Tax rate is current 20% and will reduced it to 19% with effect from 1 April 2017. The Government has confirmed its commitment to cut the corporation tax rate to 17% by 2020, just in time for the next election!

Capital allowances

In the interests of promoting the wider uptake of electric vehicles, expenditure incurred on electric charge point equipment on or after 23 November 2016 will qualify for a 100% first-year allowance. The allowance will expire on 31 March 2019 for corporation tax purposes and 5 April 2019 for income tax purposes.

Finance cost relief for landlords

The Government will restrict the tax relief on finance costs that individual landlords of residential property currently receive. The restriction will be phased in over 4 years, starting from April 2017.

The Government believes that the current tax system supports landlords over and above ordinary homeowners. To counter this, the Government is to restrict the tax relief on finance costs (such as mortgage interest, interest on loans to buy furnishings and fees incurred when taking out or repaying loans) that individual landlords of residential property can get to the basic rate of tax. Furnished holiday lets are excluded from this reform.

Landlords will be able to obtain relief as follows:

- in 2017–18, the deduction from property income (as is currently allowed) will be restricted to 75% of finance costs, with the remaining 25% being available as a basic rate tax reduction;
- in 2018–19, 50% of finance costs as a deduction and 50% given as a basic rate tax reduction;
- in 2019–20, 25% of finance costs as a deduction and 75% given as a basic rate tax reduction;
- from 2020–21, all financing costs incurred by a residential landlord will be given as a basic rate tax reduction.

National Minimum Wage

New rates

The Chancellor announced that the NLW, which applies to all employees aged 25 or older, will increase to £7.50 per hour from 1 April 2017.

The NLW, which is effectively the highest rate of NMW, is currently set at £7.20 per hour. The National living wage increases by over 4%

The other rates of NMW will also go up in April 2017. The changes in all NMW and NLW rates are as follows:

		Current hourly rate to 31 March 2017	New hourly rate from 1 April 2017
Workers aged 25 & over	National living wage	£7.20	£7.50
Workers aged 21 & over	NMW: standard adult rate	£6.95	£7.05
18–20 year olds	NMW: youth development rate	£5.55	£5.60
16–17 year olds	NMW: young workers rate	£4.00	£4.05
Apprentices	NMW apprentice rate	£3.40	£3.50

Value Added Tax

Changes to the VAT Flat Rate Scheme

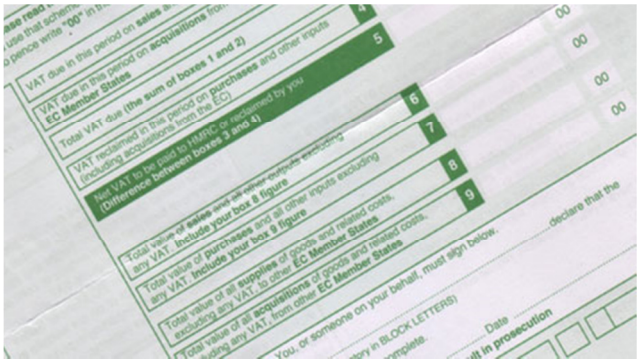
The Flat Rate Scheme for VAT was introduced by HMRC in 2002 to simplify the paperwork for small businesses in their calculation accounting and paying VAT who have taxable supplies (sale of goods and services) of less than £150,000 pa (exclusive of VAT). Businesses apply a fixed rate, dependent upon their industry, to their gross of VAT income. They do not reclaim VAT on their expenditure except if they purchase capital goods e.g. equipment costing over £2,000 (inclusive of VAT) for use in their business.

VAT is calculated at 20% of net sales. Putting this another way, VAT is calculated at 16.67% (20/120) of the gross of VAT price. A consultant, bookkeeper or engineer, for example, can use a 14.5% Flat Rate. They there can make a profit of 2.17% of their gross sales price. This profit is taken at the expense of being unable to reclaim VAT on their expenditure. However, if the business has no, or little, input VAT on its costs then it can profit from using the scheme. In the above example, a business with net sales of £50,000 can make a profit of £1,302 pa calculated at 2.17% of their gross sales of £60,000,

In order to tackle perceived abuse of the VAT Flat Rate Scheme, a new 16.5% VAT flat rate will apply from 1 April 2017 for businesses with limited costs. Any business defined as a 'limited cost trader' may not use a different rate beyond 1 April 2017. An easy-to-use online tool will be provided to help businesses determine whether they should use the new rate.

Limited cost traders are defined as those whose VAT inclusive expenditure on goods is either (i) less than 2% of their VAT inclusive turnover in a prescribed accounting period; or (ii) greater than 2% of their VAT inclusive turnover but less than £1,000 per annum (pro-rata for short periods). Such traders will be required to apply a new flat rate scheme percentage of 16.5%.

To make matters worse, excluded from the definition of goods are capital expenditure, food or drink for consumption by the flat rate business or its



employees, vehicles, vehicle parts and fuel (except where the business is one that carries out transport services). These exclusions are part of the test to prevent traders buying either low value everyday items or one off purchases in order to inflate their costs beyond 2%. The cost of services used by business is ignored for the above rule. This will affect many small professional businesses that pay considerable amount for software, rent etc.

This will affect most personal services companies, consultants, accountants, lawyers, locum doctors, engineers and most labour-only businesses from using the flat scheme. They will be forced to apply a higher flat rate scheme percentage or leave the scheme completely. Any business that trades below the VAT threshold of £83,000 but have registered for VAT voluntarily to use the flat rate scheme because they have minimal costs could also be affected. These businesses will need to apply the test on an annual basis by looking at their previous year's purchases, although the press release does not make that clear. This may mean that small businesses on the scheme will need to keep something close to full VAT records which is precisely what the scheme is intended to avoid.

Paying or invoicing in advance to avoid an increase in tax is known as forestalling. Anti-forestalling legislation has also been published to prevent any business defined as a limited cost trader from continuing to use a lower flat rate beyond 1 April 2017.

Businesses using, or thinking of joining, the Flat Rate Scheme, must determine by 1 April 2017 whether they are a limited cost trader.

Draft legislation will be published on 5 December 2016 and businesses will have 8 weeks to comment.

Investments

Savings bonds

National Savings and Investments (NS&I) will launch a new three-year savings bond in 2017 offering an interest rate of 2.2% per annum. The bond will be open to those over 16 years of age and the maximum investment will be £3,000.

Taxation of investments

As previously announced, the ISA limit will increase from £15,240 to £20,000 in 2017-18.

Junior ISAs and Child Trust Fund limits

The proposed increase in the annual subscription limit to £4,128 will take effect from 6 April 2017.

Pension investment and flexibility

The pension's reform introduced in 2014 has opened up some additional opportunities to recycle pension investment. It is possible for members of defined contribution (DC) schemes to withdraw income from a flexi-access drawdown fund and re-invest it, thus obtaining tax relief a second time.

If, for example, a member withdraws £40,000 from his uncrystallised fund, 25% is tax free and the balance of £30,000 is transferred to a flexi-access drawdown fund. If income is drawn from that fund, subject to tax, and gradually reinvested as a new pension contribution, the taxed income will attract further tax relief and replace the £30,000 originally withdrawn. 25% of the replaced pension may again be withdrawn tax free. Each pension contribution receives tax relief at 20% or 40%, but when it is withdrawn it is only taxed at an effective rate of 15% or 30% because of the tax free element. Over time, repeated recycling gradually shifts funds from the taxable fund to the tax free fund.

Recognising this unintended advantage of pension's flexibility, a limit of £10,000 per annum was placed on the amount that can be invested in a pension once income has been drawn from the flexi-access fund. This restricted amount is termed the Money Purchase Annual Allowance (MPAA).

The proposal in the Autumn Statement is to reduce the MPAA to £4,000 with effect from April 2017.

It should be noted that the MPAA, whether at the current level of £10,000 or the proposed lower level of £4,000, is only triggered when a pension scheme member draws income from a flexi-access drawdown fund. It is not triggered if the member uses only the tax free lump sum and does not draw income from the taxable portion of the fund.

The increased freedom to draw on pension savings, whilst welcomed by many, has inevitably led to an increase in people being defrauded of their savings or being persuaded to make unwise investments. The government is to consult on banning pension cold-calling, in a crackdown to reduce losses to the public through scams.

State pension

The triple-lock on the State Pension annual increases is set to be protected. This is great for pensioners.

Other matters

The Government announced that letting agents will no longer be able to charge renters fees, for example when they sign a new tenancy agreement. This will be subject to consultation in due course, though the Chancellor in his speech indicated he wished to see the reform made 'as soon as possible'.

Insurance Premium Tax

The rate of Insurance Premium Tax (IPT) will rise from 10% to 12% on 1 June 2017. IPT increased previously, on 1 November 2015, from 6% to 9.5%.

All Paul Limited

About us

All Paul Limited is a modern, independent and proactive firm of Chartered Certified Accountants based in north Leeds.

We provide all the usual essential services that you'd expect e.g. annual accounts, self-assessment tax return preparation, recordkeeping and payroll. In addition, we offer tax planning, business set-up and limited company formation as well as Sage 50 software training and support.

Our objective is simple; to be viewed by our clients as the first point of contact for all their financial, advisory and compliance needs. We achieve this by providing sensible advice and tailored solutions to help clients achieve their commercial and personal goals.

The firm is run by Paul Clifton who offers a wide range of accounting and tax expertise to local businesses. Paul has worked with smaller owner-managed businesses, through firms of Chartered Accountants, for over a quarter of a century.

He works with business owners providing them with practical help and advice on a day-to-day basis.

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Our clients are located mainly in north Leeds, but they also come from the surrounding towns. They mainly operate as limited companies and sole traders. Alongside all of the services we offer to the business, we always recognise the importance of the personal circumstances of the business owner.

If you have any questions about the implications of the above, either for you or your business, and would like further advice then please do give us a call. We provide out-of-hours flexible appointments. We are happy to meet you in the evening when you may have more time. So call **All Paul Limited** today on 0113 225 2232 or email us at **info@all-paul.co.uk**. More details about our services can be found by visiting our website at **www.all-paul.co.uk**.

What our clients say about us

"A highly professional service, quick to respond, attention to detail and knowledgeable. I just know I'm in safe hands with All Paul Limited".
Nick S. YorTours, Harrogate

"I was impressed by the breadth of your financial knowledge and have every confidence to recommend you to other people." Karl H. Martin James Property Services, Leeds

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