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Delay for income shifting law

Someone listened to small businesses

Our October 2007 newsletter warned of the crackdown on small businesses that distribute profits to individuals who make unequal contributions to the business. The Government refers to this behaviour as 'income shifting'.

Draft proposals to counter income shifting where it saves tax overall were released for consultation in December 2007, and were criticised as being completely unworkable. Fortunately someone in the Treasury listened and the income shifting law will be delayed until at least 6 April 2009. Unfortunately we now have another year of uncertainty for small businesses while taxation policy is redrafted.

Relief for Entrepreneurs

The Chancellor has confirmed a new capital tax relief will be available when you sell part or all of your business, or shares in your own company, after 5 April 2008. For deals made after that date taper relief and indexation allowance are lost, which increases the effective tax rate from 5% (for basic rate taxpayers) or 10% (for higher rate taxpayers) to a flat 18% rate for all taxpayers.

The new entrepreneurs' relief restores the effective tax rate on the gain to 10%, before deduction of your annual exemption or any capital losses. However, the relief only applies to the first £1 million of gains made on and after 6 April 2008. Gains in excess of £1 million, or which do not qualify will be taxed at 18%.

The disposal must also meet some tight conditions to qualify for entrepreneurs' relief:

- The business must be 'trading' so property letting does not qualify, unless it is furnished holiday lettings.
- A single business asset, such as a building, must be disposed of at the same time as the associated business. Restrictions for ownership periods and non-business use will apply.
- You must have held the business assets or 5% of the voting shares of the company for at least one year before the disposal.
- Only shares in a company you have worked in, or been an officer of, for at least a year, will qualify.

If you are planning to sell your business the new entrepreneurs' relief may allow you to defer the sale until after 5 April 2008, and still pay the same amount of tax. But sales of shares acquired through employee share schemes are unlikely to qualify for entrepreneurs' relief.

Employee Share Schemes

The Enterprise Management Incentive (EMI) is a useful share option scheme that can be used by smaller companies to help attract and retain employees. If the scheme is operated correctly the employees can acquire shares and not be charged income tax or national insurance on the value of those shares. The limit on the value of share options issued to each employee is raised to £120,000 for options granted on and after 6 April 2008.

The company can have no more than £3 million of its shares under option at one time. In addition only companies with up to 250 employees will be able to issue new EMI options from the date the 2008 Finance Act is passed.

Tax Data 2008/09

Income Tax
Personal Allowance £5,435
Tax rates:
Savings to £2,320 @10%
Earned to £36,000 @20%
All above £36,000 @ 40%
Tax on dividends:
to £36,000 @ 10%
above £36,000 @ 32.5%

National Insurance
Class 1 employers:
12.8% over £5,435
Class 1 employees:
11% on £5,435 to £40,040
plus 1% above £40,040
Class 4:
8% on £5,435 to £40,040
plus
1% on profits over £40,040
Class 2: £2.30 per week
Class 3: £8.10 per week

Capital Gains Tax
All gains taxed at 18%
Annual exemption: £9,600

Inheritance Tax
Nil rate band: £312,000
Unused band transferable to spouse on death.
Excess taxed at 40% on death.

Pension Contributions
No earnings: £3,600 gross
Otherwise:100% earnings
Annual tax relief: £235,000
Pension fund cap: £1.65 m

Corporation Tax
Small co: 21% to £300,000
Marginal: 29.75% to £1.5m
Large co: 28% over £1.5m

VAT turnover thresholds
Registration over: £67,000
Dereg' under: £65,000

VAT schemes maximum
Flat rate small business: £150,000 turnover
Cash & Annual Accounting £1.35 m turnover

Stop Press

From 6 April 2008 when you are present in the UK at midnight this will count as a day in the UK for tax purposes. Days spent in transit between airports are not counted, unless you stop off for a business meeting.

Income tax changes

Tax is not that simple

We were told last March that basic rate of tax will drop from 22% to 20% on 6 April 2008 and the starting rate of 10% will go. But that is not strictly true.

The 10% tax band has been abolished for all income except for **savings income**. Most people will pay 20% tax on all of their taxable income up to £36,000 in 2008/09, and 40% on income above that threshold. However, UK dividends are still taxed at 10% up to £36,000 and at 32.5% above £36,000. The 10% dividend tax credit means as a basic rate taxpayer you pay no additional income tax on dividends.

Savings income is basically interest paid by banks and building societies. It is taxed as a slice on top of your earned income but before your dividend income. The first £2,320 of savings income is taxed at 10%, if your other earned income hasn't already pushed you into the 20% rate.

Example

In 2008/09 you take a salary of £5,435 and gross dividends of £33,000 from your company. You also receive £2,000 in gross interest from a savings account. Your personal allowance of £5,435 covers your salary leaving nothing taxable. The gross interest is taxed as the next slice of your income, and falls within the savings income band of up to £2,320, so is taxed at 10%. Your total taxable income amounts to £35,000 (£33,000 + £2,000), which is within the £36,000 limit for higher rate tax, so all of your dividend income is taxed at 10%

EIS relief

The only income tax relief to be extended in the Budget is EIS relief, available when an individual subscribes for EIS shares. He can claim income tax relief of 20% of the amount subscribed, up to a limit of £400,000. This caps the income tax relief at £80,000 (20% x £400,000) for each tax year. This income tax relief is increased to £100,000 on an investment of £500,000 made from 6 April 2008.

Capital allowances and cars

The new Annual Investment Allowance (AIA), which gives 100% deduction for the cost of new equipment up to a total of £50,000 per year, will come into effect from April. The cost of assets not covered by the AIA is given tax relief by an annual 20% writing down allowance (WDA), or at 10% for equipment that is an integral feature in a building.

Most small businesses won't have to worry about claiming the WDA on new equipment as the full cost will be covered by the £50,000 AIA. However, you will need to continue to claim the WDA for equipment purchased before April 2008, which has not yet been given full tax relief. This could be a pain as the amounts of unrelieved costs get progressively smaller each year. Now for accounting periods starting on or after 1 or 6 April 2008 (depending on the structure of your business) you will be able to write off the full cost of old assets, where the total unrelieved cost is £1,000 or less.

The capital allowances system for company cars is to be reformed from **April 2009**, not from April 2008 as we had been lead to believe. The new system will categorise all cars on the basis of their CO_2 emissions.

More smog less tax relief

Low emissions cars will continue to qualify for a 100% first year allowance, but the definition of low emissions will be changed from CO_2 of 120g/km or less, to 110g/km or less from **1 April 2008** (note the earlier year). High emissions cars are those with CO_2 emissions of 160g/km or more and will only qualify for a 10% WDA. All other cars will qualify for a 20% WDA. This new system will lengthen the time taken to get full tax relief for the cost of cars, particularly for higher polluting vehicles.

Three cheers for VAT changes!

Registration

If your business is not VAT registered you now have more headroom for sales before you must register for VAT. The compulsory VAT threshold is increased from £64,000 to £67,000 from 1 April 2008. This covers vatable sales in the previous 12 months, or sales expected in the next month. You can register voluntarily for VAT when sales are below this threshold. If your sales drop below the deregistration threshold (£65,000 from 1 April 2008) you can ask to be deregistered for VAT.

Small errors

As a VAT registered business you may make small errors in your VAT calculations. If the total net error amounts to no more than £2,000 you can work the under or over payment into your next VAT return. If the VAT difference is more than £2,000 you should write to the VAT office and confess. Unfortunately this normally generates a demand for interest on the late paid VAT. This error reporting threshold will be raised to the greater of £10,000, or 1% of the reported turn-over for the VAT quarter, subject to a cap of £50,000. This will apply for accounting periods beginning on and after 1 July 2008.

VAT claims

Where you have overpaid VAT, HMRC prevent you from reclaiming overpayments for periods ending over three years ago. The House of Lords has just ruled this three year cap is illegal. You now have until 31 March 2009 to reclaim overpaid VAT from periods before 4 December 1996 and claim VAT on purchases for periods prior to 1 May 2006. We can help you draft your claim.