TAX MATTERS

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Since my last newsletter a lot has happened - we've had an Election and two Budgets the most recent of which has created a number of issues for different groups of taxpayers. In this newsletter I deal with three of those topics and encourage you to visit our website where I have a number of blogs which deal with these topics in more detail. We also have the Autumn statement next week which may bring further changes. As with anything you see in this newsletter which sparks interest or raises questions please do not hesitate to contact me for further information.

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Dividends - the new rules

One of the biggest surprises in the Summer Budget of this year was the radical change to the tax treatment of dividends proposed for April 2016. For many taxpayers, primarily those with small portfolio holdings, the change is good news and should result in a reduction in their personal tax liabilities from April onwards. However, for many, business owners in particular, the change has been greeted with dismay as for many of these taxpayers the change will result in a marked increase in their personal tax liabilities.

The change seems to a thinly veiled attack on the practice undertaken by many owner managed business men and women where they take small salaries from the business topping this up with regular dividends as profits allow. The result of this approach is a reduction in the total tax liability primarily because dividends do not attract National Insurance. The Government do not like this practice, which is being followed by a number of those that contract with the Government, and there have been a number of attempts to deal with this in the past. The proposed change will not remove the advantage of paying dividends; rather, it will simply reduce the advantage. It is not a great leap of imagination to suggest that the Government might increase the dividend tax rates in the future such that there is no tax advantage in taking dividends instead of salary. As an example – for taxpayers paying tax at the highest rate the increase in tax payable on a dividend of £100,000 is £7,500 from next April. Even with more modest dividends the tax disadvantage can run into thousands of pounds.

So what planning can be done in advance of the change to lessen the impact?

There are perhaps two main planning thrusts:
The first is for companies to consider voting dividends in advance of the change thereby ensuring that shareholders pay tax at the lower rates. This of course will advance the payment of tax on the dividend with the balancing payment due by 31 January 2017.

Such a company may also require the amount of the dividend to be credited to a loan account in favour of the shareholder so as to ease the cash flow burden on the company with amounts drawn down when the company has free cash. As with all dividends distributable profits must be available to satisfy the dividend. Particular care is needed if dividend waivers are to be used; and

Ensuring that the shareholding structure is such that wherever possible personal allowances and basic rate bands are being fully utilised in preference to dividends falling to be taxed at higher rates. It is important that when changes in shareholding structure are proposed all angles and taxes are considered.

It will be interesting to see whether the Government will try to eliminate the advantage with future increases in the dividend tax rates. The Government's approach to entrepreneurs seems to be slightly disingenuous at the moment. The Government says that it fully supports entrepreneurship here in the UK whilst at the same time meddling with the one element of the tax landscape which is providing entrepreneurs with welcome tax savings. As with many tax changes watch this space.

IHT and the family home

In the lead up to the Election there was much talk of the increase in the IHT nil rate band to £1 million. This has happened but it is not quite what it seems. The individual nil rate band prior to the Election was £325,000. With the ability for a surviving spouse to take over any unused band of a deceased spouse this could be doubled to give £650,000 which would be available on the second death. In the Summer Budget Mr Osbourne announced the arrival of the 'family home allowance' of £175,000 per individual. Again if doubled and added to the existing doubled nil rate band this gives £1 million. However, the full £175,000 will not be available until 2020 with an allowance of £100,000 available from April 2017 increasing to the full amount in 2020. The allowance will also be reduced on a proportionate

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basis for estates worth more than £2 million. The allowance will only apply if the main residence is left to one or more direct descendants on death. Direct Descendants will be children of the deceased and their lineal descendants. This will include step, adopted and fostered children. The allowance will be increased in line with the consumer prices index from 2021/22 onwards. Taxpayers may want to consider the provisions that they have already made in their wills and assess whether or not any changes are needed.

Buy to let dilemma

Another surprise change announced in to the Summer Budget is the reduction in mortgage interest relief for buy to let landlords. There are perceptions amongst many that buy to let activities are distorting the property market and preventing many first time buyers from buying a home because of the competition they face from the buy to let landlords.

The proposal is to be fully effective by April 2020 and will simply reduce the tax relief on qualifying interest to the basic rate. At present, tax relief is available to landlords at their marginal rate of income tax which could be as high as 45%. Reducing the tax relief for interest will obviously affect the financial models for many landlords and may encourage many to leave the market completely. However, for perhaps the more commercially minded landlords, who are dealing with the activity as a commercial proposition rather than a hobby, they will redraft their financial models which may simply result in rents being increased.

So what should landlords be considering now in the run up to the changes?

- Can the increased cost be passed on to tenants? If so can that be achieved by increasing rents now or gradually over time?
- Can borrowings be reduced such that the impact is reduced?
- Can the business structure be changed to eliminate the problem? The restriction only applies to property held personally there is no restriction on tax relief for interest on borrowings for property held in a company. Transferring property to a company is not straightforward and can cause unavoidable tax liabilities the prime one of which may be SDLT. Planning possibilities do exist for property activities which are conducted on a commercial basis where a number of properties, are involved. However, for the hobby landlords with a small number of properties, which are being dealt with as an addition to employment say, the planning possibilities are limited.

In the run up to the change, landlords will need to look carefully at their financial models to see whether or not changes can be made to accommodate the new rules.

Again, as with dividends this may be the first step in the abolition of an advantage for buy to let landlords. Alternatively landlords may decide to exit the market and find alternative investment opportunities.

Income tax returns

The income tax return season is now fully underway with many taxpayers dreading the thought of looking through all their tax papers. A few pointers may be helpful for those who are yet to prepare their return or collate the information for their advisers:

- If a repayment is anticipated for 5 April 2015 the sooner the return is submitted the sooner the repayment will be processed;
- Note that the quickest way to get a repayment is by including the necessary bank details on the return and have HMRC send the payment directly. Cheques mysteriously do take a while to materialise! Note also that if you are in a position where payments on account are a normal routine, if a repayment is due and you do not get your return in more than 45 days in advance of the 31 January, HMRC will hold the repayment to set it against any payment on account which may be due thus losing you the cash flow advantage;
- If you normally make payments on account, because of high levels untaxed income such as dividends or property profits, now is the time to consider the likely outcome for the current year i.e. the year ending 5 April 2016 so that an assessment can be made prior to 31 January 2016 of the likely tax outturn before the first payment on account is due. In many cases payments on account can be reduced because of a reduction in untaxed income when compared with 5 April 2015;
- The deadline for HMRC to enquire into a tax return is 12 months from the date the return is filed. If a return is processed and a payment or repayment is agreed this does not necessarily mean that HMRC will not raise enquiries with regard to the return;
- If you have any unusual transactions in the year make sure that you fully explain the transactions so that HMRC will be aware of the facts and the tax treatment which has been adopted. If HMRC find something which they are unaware of they can enquire into earlier years. i.e. outside the 12 month period, if they believe that an appropriate disclosure has not been made and tax may be due, This is what is known as 'discovery'. This can be costly if tax underpayments are identified; and
- As result of the last point missing items off an income tax return (either intentionally or unintentionally) is never a wise move, HMRC receive information about the tax affairs of individual and company taxpayers from a variety of sources. This leaves them to expect to see certain things on tax returns e.g. banks and building societies report interest received to HMRC, employers report benefit in kind transactions to HMRC. So do not think that non-disclosure is a 'clever' move - it can lead to cost and heartache.

Do not leave tax returns until the last minute. The electronic filing deadline of 31 January may seem a long way away but it will be here in no time!