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Welcome...

To June's Tax Tips & News, our newsletter designed to bring you tax tips and news to keep you one step ahead of the taxman.

If you need further assistance just let us know or you can send us a question for our Question and Answer Section.

We are committed to ensuring none of our clients pay a penny more in tax than is necessary and they receive useful tax and business advice and support throughout the year.

Please contact us for advice on your own specific circumstances. **We're here to help!**

June 2017

IHT: main residence nil-rate band

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From April 2017, each individual spouse or civil partner will be offered a residence nil rate band (RNRB), which is designed to **help pass on a home to 'direct descendants'**, including children or grandchildren, tax-free after their death. The rules governing the inheritance tax (IHT) nil rate band are complex and it is always recommended that prior professional advice is considered.

Phasing in of RNRB

The RNRB is being phased in over a four-year period as follows:

- £100,000 in 2017-2018
- £125,000 in 2018-2019
- £150,000 in 2019-2020
- £175,000 in 2020-2021

Broadly, the new RNRB will be added to the existing £325,000 IHT threshold, meaning the total tax-free allowance for a surviving spouse or civil partner will be up to £850,000 in 2017-18, and up to £1 million in 2020-21.

For the purposes of the new nil-rate band, 'direct descendants' include the spouse or civil partner, children, step children, adopted children, foster children, and any lineal descendants.

The property in question must be a 'qualifying residence'. This means it must be a property where a person held an interest and had occupied the property as their residence at some point. HMRC may require evidence of this, so it is essential to maintain proper records to help substantiate a claim.

Where a person has more than one property, an election can be made so that the exemption is offset. For the purpose of the exemption, there is no requirement for the property to be the main residence at death.

Tapering

The new allowance will be tapered away from those leaving an estate of more than £2 million, so that those leaving more than £2.35m will not benefit from it.

For estates (broadly, assets less liabilities) exceeding £2 million, the RNRB (£100,000 for 2017-18) is reduced by £1 for every £2 over the £2 million threshold. The effect of tapering is an extremely important planning point, particularly where the whole of an estate is being left to a surviving spouse or civil partner - whilst no IHT will be charged on first death, the amount of RNRB that may subsequently be transferred to the surviving person may be affected by the taper.

If there is no qualifying residence or the residence is left to someone who is not a direct descendant, upon the first death of one spouse or civil partner, the RNRB will not be available. However, the surviving spouse or civil partner may be able to benefit from the unused RNRB when they subsequently die. On the death of the surviving spouse or civil partner, they will be entitled to two times the RNRB. Note that for this to happen, a claim would need to be made within two years of the death of the second spouse or civil partner.

There is an additional benefit to this exemption which will naturally affect a number of people whom in their old age may wish to, or require to, either downsize or dispose of their residence (move in with family or into a care home). Provided that the sale of the property occurred on or after 8 July 2015, the RNRB will not be lost. Instead, the exemption can be maintained and used against either the remaining value of their smaller residence or equivalent value of assets (provided it has been left to a direct descendant).

In the event that the property was given away, the RNRB can be available, provided the gift was made on or after 8 July 2015, and assets of a similar value have been left to a direct descendant.

The calculations for the RNRB where a residence has been downsized, sold, or gifted are extremely complex and careful planning is required to ensure the exemption is not lost. It is extremely important that proper records of sales and/or purchases of residential property are maintained.

Reform of landlords' taxation?

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The government's plans to allow landlords to use the cash basis for tax purposes were confirmed in the 2017 Spring Budget, but although the proposed legislation was included in Finance Bill 2017, it did not appear in the much reduced Finance Act 2017, which received Royal Assent on 27 April 2017. It is likely that the proposals have been temporarily shelved, pending the outcome of the General Election, and are expected to reappear in a second Finance Bill later this year. If the provisions are subsequently enacted, they are expected to apply retrospectively from 6 April 2017, i.e. for the current tax year.

Up to and including 2016-17, profits of a property business must be calculated in accordance with generally accepted accounting practice (GAAP), commonly referred to as the accruals basis. Although this remains the case for certain landlords (including companies, LLPs, corporate firms, and trustees of trusts), if the Finance Bill 2017 provisions are enacted, the position for 2017-18 onwards will be more complicated. The general rule is that the cash basis must be used. However, this is subject to some exceptions and there will be scope for the individual to elect to continue using the accruals basis if they so wish. The new property allowance will remove some landlords from income tax, whilst for others, it will provide a deduction from profits of £1,000.

Property allowance

The property allowance works as follows:

- **Full relief:** if income from a property business for the tax year is equal to or less than £1,000, no income tax will payable in respect of that property business for that year. Individuals may elect to use the rules normally applying to calculate profits.
- **Partial relief:** if income from a property business for the tax year exceeds £1,000, the individual may elect to deduct £1,000 from his income - rather than the expenditure actually incurred - in arriving at the profits of the property business.

A number of restrictions apply. The property allowance will not apply:

- to income on which rent-a-room relief is given; or
- where the 'alternative method' is not elected, but instead the actual allowable expenses are deducted.

Cash basis

The cash basis operates by reference to the tax year. This means that profits are calculated for the tax year by adding or subtracting:

- all income received in connection with the property business in the tax year;
- any income that is not taxable and for expenses which are not allowable.

Reform of capital expenditure rules

To date, the cash basis rules have prohibited a deduction for expenditure of a capital nature unless such expenditure would qualify for plant and machinery capital allowances under the ordinary tax rules. However, if the Finance Bill 2017 proposals are enacted this general disallowance of capital expenditure rule will be replaced from 2017/18 onwards with a more limited disallowance of capital expenditure incurred in relation to assets which are not used up in the business over a limited period.

So, if enacted, from 2017/18 onwards, relief will be prohibited only in relation to costs incurred in relation to the provision, alteration or disposal of:

- any asset that is not a 'depreciating asset' (to be defined as having a useful life of up to 20 years);
- any asset not acquired or created for use on a continuing basis in the trade;
- a car (but of course business mileage-based relief is available);
- land (as defined);
- a non-qualifying intangible asset, (as per Financial Reporting Standard 105) including education or training; and
- a financial asset.

Costs in relation to the acquisition or disposal of a business, or part of a business, will also be excluded.

On entering the cash basis, which many taxpayers will do for 2017-18, it will be necessary to adjust for:

- amounts which, applying the cash basis, would have been brought into account for a period before the change and were not brought into account; and
- amounts which, applying the cash basis, should be brought into account for a period after the change and were brought into account for a period before the change.

These adjustments are designed to ensure that no amounts are either left out of account or double counted. The adjustment income/expense is brought into account on the last day of the first period of account under the cash basis.

Similar rules apply where a taxpayer leaves the cash basis with the exception that adjustment income is automatically spread over six years unless an election is made to accelerate the charge.

Given the uncertainty of the current situation, clients are encouraged to ensure that all income and expenditure is recorded, particularly where clients are intending to make use of the property allowance. If the proposals are not enacted, or are delayed to a future tax year, the client will need to report their actual income and expenditure and so it is important that adequate records are kept.

CGT annual exemption: use it or lose it!

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Capital gains tax (CGT) is normally paid when an item is either sold or given away. It is usually paid on profits made by selling various types of assets including properties (but generally not a main residence), stocks and shares, paintings, and other works of art, but it may also be payable in certain circumstances when a gift is made.

The most common method for minimising a liability to capital gains tax is to ensure that the annual exemption is fully utilised wherever possible. Whilst this is relatively straight-forward where only capital gains are in question, the computation can be slightly more complex where capital losses are also involved.

Where a loss arises on the sale of assets it can be offset against any other gains made in the same year or in the future. However, **a strict order applies for setting-off losses.**

Firstly, losses arising in the tax year are deducted from any other chargeable gains for the same year. All losses for the year must be deducted, even if this results in chargeable gains after losses below the level of the annual exempt amount. If the allowable losses arising in the tax year are greater than the total chargeable gains for the year, the excess losses can be carried forward to be deducted from chargeable gains in future years. In this situation, the annual exemption for the year in question may be lost.

If chargeable gains remain after deducting the allowable losses arising from the same year, unused allowable losses brought forward from an earlier year may then be deducted. It is only necessary to deduct sufficient allowable losses brought forward to reduce the chargeable gains after losses to the level of the annual exempt amount. Any remaining losses brought forward are carried forward again without limit, to be deducted from chargeable gains in future years.

Plan ahead

For 2017/18, most individuals will be entitled to an annual exemption of £11,300, which means that no CGT will be payable on gains up to that amount for that tax year. Since spouses and civil partners are each entitled to the exemption, for jointly held assets, there is scope for exempting £22,600 worth of gains in 2017/18.

The annual exemption is good only for the current tax year - it cannot be carried forward or taken back to an earlier year - so anyone planning to make a series of disposals, may want to consider the timing of sales between two or more tax years to use up as much and as many annual exemptions as possible.

Brexit legislation update

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The House of Commons Library has published two research briefing papers entitled Brexit timeline: events leading to the UK's exit from the European Union and Legislating for Brexit: the Great Repeal Bill.

The Brexit timeline paper provides a timeline of the major events leading up to the referendum and subsequent dates of note, looking ahead to expected events as the UK and EU negotiate Britain's exit. The Queen's speech at the State Opening of Parliament, scheduled for 19 June 2017, **will include the Great Repeal Bill in the Government's legislative programme**, along with a number of other Brexit-related bills. It is anticipated that the bill will subsequently be passed in late 2017, or early 2018. Broadly, the Great Repeal Bill will repeal the European Communities Act 1972 and, wherever practical and appropriate, convert EU law into UK law from the date Britain leaves. Publication of the bill is expected soon after the Queen's speech.

The briefing paper Legislating for Brexit addresses each of three main elements of the Great Repeal Bill, namely, the repeal of the European Communities Act (ECA); the transposition of EU law; and the proposed use of delegated powers. In addition, it considers the complex interaction with devolution, including the possibility of consent motions from the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly, the mechanisms for coordination with the devolved administrations, and the replacement of EU framework legislation on matters of devolved competence such as agriculture or fishing. The briefing also covers how the Bill might address the status of EU-derived law post-Brexit, and in particular the judgments of the Court of Justice of the European Union.

The House of Commons Library estimates that 13.2% of UK primary and secondary legislation enacted between 1993 and 2004 was EU related. The review of all EU-related legislation, as well as that which will be transposed by the Great Repeal Bill, makes this potentially one of the largest legislative projects ever undertaken in the UK. The White Paper indicates that the corrections will require between 800 to 1000 statutory instruments!

June questions and answers

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Q. Before I became registered for VAT, I bought a capital item from a friend, which cost £1,000. As it was a private purchase, I did not pay any VAT. I have now joined the flat rate scheme (FRS) for VAT and have just sold the same item for £500. Should I have charged VAT on the sale and included the gross total in my calculation for flat-rate VAT?

A. HMRCs VAT Notice 733 at paragraph 15.9 confirms that where input tax is reclaimed on capital expenditure goods then, when the goods are eventually sold out of the business, you must account for output tax at the appropriate VAT rate for the sale (not at the flat rate). The guidance goes on to say that if you have not claimed input tax on capital items, either by choice or because it was not allowed, you must include the sale of those items in your flat rate turnover.

Q. I was made redundant from my job on 1 March 2016 and I received a termination package of £25,000. I was then re-employed by the same company on 1 November 2016, but was made redundant from that job too on 1 March 2017. I was paid a further redundancy payment of £10,000 when I left in March 2017. Does the £30,000 redundancy exemption apply to each payment I received?

A. I'm afraid not! Since your employer remained unchanged you are only entitled to one £30,000 exemption. The whole of the first payment of £25,000 is exempt, but only £5,000 of the second payment. You will be taxed on the remaining £5,000 in 2016/17.

Q. I reached state retirement age in March 2016 but deferred receiving my state pension for 12 months. I have been informed that I can now take a lump sum in addition to my regular state pension. Is the lump sum taxable?

A. The lump sum is taxed as income. In simple terms, the rate of tax that applies to the lump sum will be the highest rate that applies to your other income for that tax year. This means that:

- if you are not liable to tax for that tax year on your other income, ignoring any deductions from that income for the marriage allowance or married couple's allowance, no tax should be deducted from any state pension lump sum you receive;
- if you are liable to income tax, you will pay tax at one of the following rates: - 20% - where taxable income does not exceed the basic rate limit (£33,500 for 2017/18);
- 40% - where taxable income exceeds the basic rate limit but does not exceed the additional rate limit of £150,000; or
- 45% - where taxable income is over £150,000.

When working out what rate of tax you should pay on any state pension lump sum, the special rates that are used to tax savings income and dividend income falling within the basic rate band - the 0% starting rate for savings, savings and dividend nil rates (personal savings and dividend allowances), are ignored. So if all your other income falls within the basic rate band of tax, you will pay tax at 20% on your state pension lump sum.

Similarly if you are a higher rate taxpayer, you will pay tax at the rate of 40% on your state pension lump sum. This will also be the case if you have dividend income that is chargeable to tax at the rate of 32.5%.

If you are an additional rate taxpayer, that is, you pay income tax at the rate of 45% (or 38.1% on dividends), you will pay tax at the rate of 45% on your state pension lump sum.

Note that different income tax rates and bands apply to non-savings and non-dividend income for taxpayers who live in Scotland and Scottish taxpayers. You will need to check the amount of tax deducted from the lump sum at the end of the tax year in which it is paid - it may not be correct. If the wrong tax rate has been used, an overpayment of tax may arise or you may have to pay more tax to make up the difference. HMRC will make the adjustment after the year end.

June key tax dates top

19/22 - PAYE/NIC, student loan and CIS deductions due for month to 5/6/2017.

Need Help? top

Please contact us if we can help you with these or any other tax or accounts matters.

In addition, if there's anyone else who you think would benefit from the newsletter, please forward the email to them or ask them to contact us to be added to the newsletter list.

New Clients Welcome top

If you are not already a client and are interested in becoming one, we would love to come to meet with you to discuss how we can help and provide you with a competitive quote for our services.

All new client consultations are provided free of charge and without obligation.

About Us top

Smith Craven Accountants are based in Doncaster, Sheffield, Worksop and Chesterfield, offering local business owners and individuals a wide range of services.

Visit our website http://www.smithcraven.co.uk for more information.

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