dte business advisers

Financial UPDATE

SUMMER 2018

The importance of inheritance tax planning

Is your estate tax efficient?

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In this issue...

With summer finally on the horizon, the Chancellor has been looking at the major changes coming for businesses and individuals, having announced 13 consultations on matters like the digital economy and plastic waste in his Spring Statement. In our feature story this issue we take a look at the furthest of all questions – inheritance tax and estate planning – and the importance of proper preparation. We also look at what Brexit could mean for businesses importing goods from the EU and how the increases in auto-enrolment pension contributions affect monthly income. Finally we offer some thoughts on the new reporting requirements for the gender pay gap, and how businesses can help close it. Please do get in touch if you want to discuss any of these topics with us.

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TAX

Lift off for the 2018/19 tax year

The new income tax rates and allowances came into effect as usual on 6 April, the start of the 2018/19 tax year. These and other tax changes are likely to affect your net income and how you plan your finances.

Many tax allowances have increased. For example, the personal allowance has risen from £11,500 to £11,850. The capital gains tax annual exempt amount is now £11,700 – up from £11,300 in 2017/18. However, the dividend allowance has been reduced to £2,000, from £5,000, and this will especially hit director-shareholders who draw most of their remuneration as dividends.

INCOME TAX DIFFERENCES

For England, Wales and Northern Ireland; the basic rate limit in 2018/19 is £34,500 (£33,500 in 2017/18) and tax rates are unchanged. This means individuals will pay 40% tax on income over £46,350.

Scottish income tax payers will see greater changes and complexity, with a new 19% starter rate band on the first £2,000 above the personal allowance, 20% basic rate charged on the next £10,150 and a new 21% intermediate rate on the next £19,430. Higher rate tax is now 41% on income between £43,430 and £150,000 and the top rate has increased to 46% for income over £150,000. Savings and dividend income is taxed in the same way as in the rest of the UK.

Directors and employees who drive company cars will also pay more tax. The benefit in kind charge for electric cars and cars with CO_2 emissions up to 50g/km has increased to 13%, from 9%. Most other rates have increased by 2%, and the diesel supplement is now 4% for cars that do not meet the Real Driving Emissions Step 2 (RDE2) standards.

The diesel supplement does not apply to hybrid cars or diesels that meet RDE2. Employees who recharge their own electric or hybrid car at work will also no longer be taxed on employer-provided electricity.

INHERITANCE TAX AND PENSIONS

The inheritance tax residence nil rate band has gone up to £125,000, and will rise by a further £25,000 a year over the next two tax years. This allowance covers property left to direct descendants, although it is tapered away for estates worth more than £2 million.

The pension lifetime allowance has been indexed to £1.03 million but the annual allowance is unchanged.

If you would like to discuss with us how you may be affected by the new rates, please get in touch.

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PENSIONS

The cost of pension contributions

Contribution rates for workplace pensions went up in April 2018. For many employees, the increases will wipe out the gains from tax changes for 2018/19.

Auto-enrolment began in 2012, with existing employers gradually joining the scheme up until February 2018. As a result, the number of people with a workplace pension has risen by nearly a quarter. The next step is an increase in contribution rates from 6 April, with another rise to come in 2019/20.

For example, Jessica is an English resident employee earning £35,000; she will save £70 of income tax in 2018/19 from the increase in the personal allowance. She will also save £31 of national insurance contributions (NICs) because of the increased NICs thresholds. However, her net of tax pension contributions will rise by £462, so Jessica's net income will have dropped by £30 a month in 2018/19.

Any employee earning around the 2018/19 higher rate threshold of £46,350 is likely to see a fall in their net income this year. They will move out of the higher rate tax band, but suffer the increased higher pension contribution threshold, leaving them with over £41 less in their monthly pay packet.

Of course, this money is not lost. It is invested in a pension, meaning there will be more funds available in retirement. But a total contribution rate of 5% is inadequate and, even after the next increase, many employees probably will still not be saving enough to retire in comfort.

> *Your total pension contributions, including employer contributions, should be a percentage of your earnings equal to half your age when you start saving.*

A rule of thumb is that your total pension contributions, including employer contributions, should be a percentage of your earnings equal to half your age when you start saving. Someone starting a pension at 30 should ideally have contributions of 15% of their gross salary going into their pension fund.

FURTHER CHANGES

Looking to the future, the government wants to lower the starting age for contributing to workplace pensions and it also aims to expand the earnings base on which contributions are calculated, although probably not until the mid-2020s.

Currently, employees aged 18 to 21 are not automatically enrolled, although they do generally have the option to ask to join their employer's workplace scheme. The government's aim is to extend auto-enrolment to the 900,000 employees aged 18 to 21 who earn over the £10,000 auto-enrolment threshold.

The government also wants to remove the lower earnings limit (£6,032 for 2018/19) so contributions are paid from the first pound earned up to the higher limit (£46,350 for 2018/19). As well as increasing the amount saved, this should improve incentives for people in multiple jobs to opt-in. It will also simplify the way employers assess their workforces and calculate contributions.

	2017/18	2018/19	2019/20
Employer minimum contribution	1%	2%	3%
Employee contribution*	1%	3%	5%
Total minimum contribution	2%	5%	8%
Earnings band	£5,876 to £45,000	£6,032 to £46,350	TBC

* If the employer pays the total minimum contribution or more, the employee will not need to pay any contributions, unless their scheme rules require it.

TAX

Don't put off your **inheritance tax planning**

When Sir Ken Dodd married his long-time partner two days before he died, he potentially saved nearly £3 million in inheritance tax (IHT) on his estimated £7 million estate.

Sir Ken took advantage of the IHT exemption for assets passed to a UK domiciled spouse or civil partner. There is no exemption for transfers to a partner who is not a spouse or civil partner, however long a couple have lived together and so-called 'common law marriage' is not recognised for tax purposes.

Few people will be able to reduce their IHT bill so readily as Sir Ken, but there are several ways you can benefit your loved ones with good estate planning, undertaken in time.

PASSING ON PROPERTY

Another benefit of marriage or civil partnership is the transfer to the surviving partner of any unused nil rate band when the first of the couple dies. The nil rate band means estates up to £325,000 are exempt from IHT, so on the second death up to £650,000 of an estate could be free of IHT.

The same goes for the residence nil rate band (RNRB), which increased to £125,000 on 6 April 2018. This allowance is available when a residence is passed on to direct descendants – children, grandchildren etc. or their spouses or civil partners. The property need only have been the deceased's residence at some point, and not necessarily the main residence. Further, the RNRB can be preserved if you downsize or cease to own a home.

The RNRB was £100,000 when it was introduced in 2017/18 and will increase by £25,000 a year to reach £175,000 in 2020/21 – that's £350,000 for a couple. However, it cannot be more than the value of the deceased's interest in the property and is tapered away by £1 for every £2 for estates over £2 million. If possible, it is worth passing on your estate so that the full RNRB will be used, or available to your surviving spouse or civil partner.

Business and agricultural properties are subject to other reliefs and you can pass them on free of IHT with no limit on value. However, you need to take care not to lose these valuable reliefs, for example by passing a farm as a lifetime gift to a child who is not using the property for agricultural purposes when the donor dies, or to a spouse who dies within two years of receiving the inheritance. IHT should be considered when setting up or restructuring a business, as well as in succession planning.

GIFTS AND PENSIONS

Lifetime gifts are a good way to reduce IHT,

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> *The RNRB was £100,000 when it was introduced in 2017/18 and will increase by £25,000 a year to reach £175,000 in 2020/21 – that's £350,000 for a couple.*

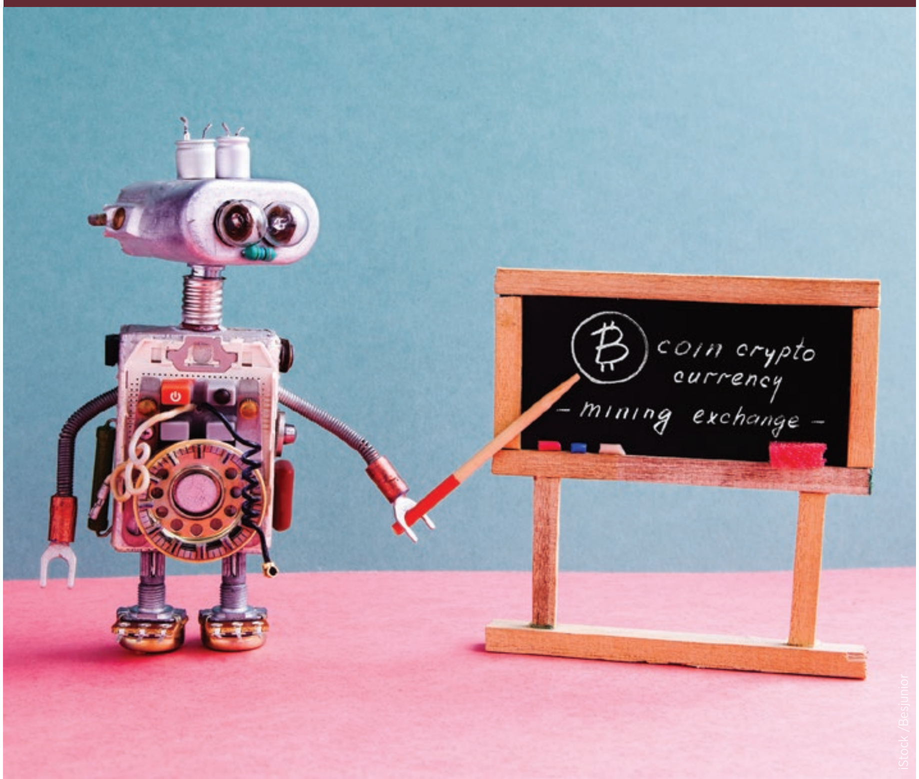
if you can afford to make them. A gift will escape IHT altogether provided you survive for at least the following seven years. It can be a good idea to insure against any liability in the event of earlier death. If you don't want to make outright gifts at this stage, you could transfer up to £325,000 into a discretionary trust. Again, if you survive seven years there will normally be no IHT to pay. But a word of warning – make sure you retain enough assets to meet your own needs.

Your pension fund can also be a powerful IHT planning tool. In general, death benefits payable from most registered pension schemes are outside the scope of IHT, although not all pensions can be passed on in this way. So it might be sensible to draw on other assets before taking income from your pension fund. There may also be income tax to pay, depending on your age, so you should always take professional advice in any pension planning.

TAX

How do you tax a cryptocurrency?

2018 has not been particularly kind to Bitcoin after a booming 2017. But anyone who invested more than a year ago should still be showing a substantial gain.



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There are now more than 1,500 cryptocurrencies, and some have seen much larger gains, especially for those investing in a currency's initial coin offering (ICO). So if you are now cashing in, what are the tax consequences?

HMRC issued guidance on how cryptocurrencies should be taxed in 2014, but this has not been updated as they have evolved. There is no mention, for example, of the tax treatment of free coins received following a cryptocurrency forking into two new currencies.

Each gain made when a cryptocurrency is converted into pounds sterling has to be considered on a case-by-case basis. A highly speculative transaction, such as the initial investment in an ICO, could be considered like gambling and therefore exempt from tax.

However, as cryptocurrencies have become more mainstream, and with more investment advice available, such treatment is now much less likely to apply. Gains will therefore normally be subject to capital gains tax. After the £11,700 exemption, the rate is 10% where a gain falls within a person's basic rate tax band, and 20% above that.

Be warned that the Treasury intends to crack down on cryptocurrencies because of tax evasion concerns.

VAT

Is import VAT coming after Brexit?

More than 130,000 UK businesses may find themselves paying VAT upfront for the first time.

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Controversial legislation making its way through Parliament will apply when importing goods from the EU after Brexit.

REVERSE CHARGE PROCEDURE

Currently, if a business acquires goods from within the EU, it accounts for VAT under a reverse charge procedure. Both the output VAT and input VAT are entered on the same VAT return so, for most businesses, there is no VAT cost because the two amounts cancel out. The only time there is a cost is if the recovery of VAT is restricted because the goods are used for exempt or non-business activities.

For example, if a UK business buys goods for £12,500 from a French company, based on the date of acquisition (typically when an invoice is issued), its VAT return will include both output VAT and input VAT of £2,500.

IMPORTS

The Taxation (Cross-border Trade) Bill will remove the concept of EU acquisitions. Instead, HMRC will treat purchases from the EU in the same way as imports from outside the EU. This is, of course, conditional on the Brexit negotiations.

The import VAT will need to be paid at the time of importation, as a condition of clearing customs. This is paid directly to HMRC, although the VAT cost will end up the same. The import VAT is then reclaimed on the next VAT return, but not until the business has received an import VAT certificate from HMRC.

HMRC currently issues these certificates on a monthly basis, and businesses should receive them by the 24th of the following month. If you are submitting quarterly VAT returns, depending on timing, there could therefore be a delay of more than five months before import VAT is recovered. For businesses that only deal with the EU, this could cause serious cashflow problems – not to mention the additional bureaucracy and processing times attached to customs processes.

For example, a UK business buys goods for £12,500 from a Chinese company. The goods are imported in April, when VAT of £2,500 will be paid. HMRC will issue an import VAT certificate by 24 May, with £2,500 to be reclaimed on the next VAT return.

This VAT change could take effect when the UK leaves the EU on 29 March 2019. So it is best to be prepared.

PLANNING POINTS

Businesses can mitigate the cashflow problems around importation, although this usually involves some kind of trade-off:

- Regular importers can set up a deferment account with HMRC, allowing import VAT to be paid monthly in arrears. It is often necessary to provide HMRC with a costly bank- or insurance-backed guarantee.

“If you are submitting quarterly VAT returns, depending on timing, there could therefore be a delay of more than five months before import VAT is recovered.

- Firms can file monthly VAT returns if they regularly receive VAT refunds, although the drawback is making 12 returns a year.
- If a business's imports are relatively infrequent, they could be timed so the import VAT certificates arrive towards the end of a VAT period.
- A business could set up a revolving credit facility to fund import VAT, but this comes at a cost.

It is sensible to prepare for the likely outcomes, such as rules generally applied to countries outside the EU, although it depends on government negotiations with the EU. Please contact us if you want to discuss the potential implications for your business.

EMPLOYMENT

Closing the gap **on equal pay**

The right to 'equal pay for work of equal value' has been enshrined in law since 1970, but the gender pay gap is still headline news nearly 50 years later.

Recent high-profile examples include a gender pay gap of 28.6% at Channel 4; the BBC paying John McEnroe ten times more than Martina Navratilova; and Claire Foy being paid less for playing the Queen than Matt Smith for playing Prince Philip on the TV show 'The Crown'. And that's just in the media.

Gender inequality can lead to low staff morale, poor employee retention rates, and litigation – with several supermarket chains recently finding out how costly legal claims can be. Such cases can also damage a company's reputation.

The law says there must be equal pay for work of equal value. Tesco is facing a £4 billion claim for back pay from thousands of its female workers, with Morrisons receiving a similar claim in March. At issue in the recent supermarket cases is whether different jobs are comparable. Are shop floor jobs, such as check-out and shelf-stacking, which are mainly done by female workers, of equal value to higher-paid jobs in male-dominated distribution centres?

In the public sector, cleaners and dinner ladies have also taken legal action on the basis that they should be paid the equivalent of binmen and street cleaners.

There is no suggestion of any deliberate disregard for the law, but rather historical divisions between male and female roles contributing to the pay differentials.

GENDER PAY GAP REPORTING

By 4 April 2018 businesses with at least 250 employees had to report their gender pay gap as of 5 April 2017, showing the difference in both mean and median hourly earnings and bonus payments.

- The mean gender pay gap is the difference between average male pay and average female pay.
- The median gender pay gap is the difference between the middle of the range of male pay and the middle of the range of female pay.

The data gathered is very general and will not show whether women are being paid less than men for equivalent roles – they simply show the overall gender pay gap within a company.

The gender pay gap has narrowed but it is currently 9.7% based on median pay for full-time workers, and it increases to 18.4% when part-time employees are included.

BEST PRACTICE

Obvious areas to review to make practical improvements include recruitment and promotion to discern whether there are any hidden or unconscious biases in selection. Mentoring and training programmes could also help with staff progression to ensure more equal representation at senior levels. It could also help to encourage greater use of paternity leave.

At some point in the future, gender pay gap reporting could be extended to smaller organisations. It is worth reviewing practices, however large or small you are as an employer. Most employees appreciate transparency in pay and both the government and ACAS believe that this will narrow the gender gap in organisations. So it might be worth publishing your organisation's gender gap even if it is below the 250 employee threshold.

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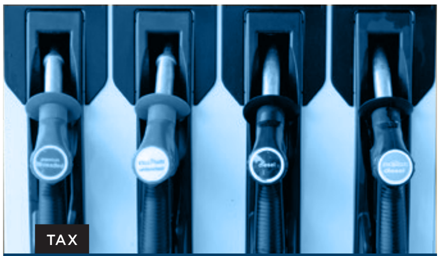

TAX

Advisory fuel rates updated

HMRC's latest advisory fuel rates offer mixed news, with both increases and reductions. The new rates apply from 1 March 2018.

HMRC's rates can be used for reimbursing employees for business mileage in company cars, and their use avoids any tax implications for the employees. You can always pay lower rates, for instance for more fuel-efficient cars, but higher rates will need to be substantiated. The advisory rates can also be used to reimburse employees' private travel.

The next review is 1 June 2018, although current rates can be used until 30 June 2018.

Engine size	Petrol	Diesel	LPG
1400cc or less	11p	9p	7p
1401cc to 1600cc	14p	9p	8p
1601cc to 2000cc	14p	11p	8p
Over 2000cc	22p	13p	13p

Hybrids are treated as either petrol or diesel.

INVESTMENT

Good and bad news for the EIS and VCTs

Important changes to the Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) rules came into effect this April. The main aim is to restrict investment in these schemes to higher risk ventures.

They will be good news for knowledge-intensive companies. However, the introduction of a risk-to-capital condition will be less welcome to many investors.

THE GOOD NEWS

The maximum you can invest in an EIS and benefit from 30% tax relief has doubled from £1 million to a total of £2 million a year. The £1 million limit still applies to normal EIS investment, but you can now invest a further £1 million in knowledge-intensive companies.

A knowledge-intensive company, very broadly, is one that spends large amounts on research and development or innovation, and either creates intellectual property or meets certain criteria on the number of highly-skilled employees.

Existing rules mean your EIS investment:

- Can be backdated to the previous tax year if you don't have sufficient tax liability for the year of investment.
- Is not normally subject to capital gains tax.
- Normally qualifies for 100% inheritance tax business relief after you have owned it for at least two years.

The age restriction for knowledge-intensive companies has been relaxed. The company generally needs to be less than ten years old, but the ten years can now start from when its annual turnover exceeds £200,000 – rather than the date of its first commercial sale.

The amount that a knowledge-intensive company can raise annually under the EIS and VCT schemes has also been doubled from £5 million to £10 million. There is still a £20 million lifetime cap on how much a company can raise, which might restrict the usefulness of the annual £10 million limit.

THE BAD NEWS

The government has introduced a risk-to-capital condition, which now applies to all EIS and VCT investments (including the Seed Enterprise Investment Scheme). Investments that have been structured to provide a low-risk return for investors will no longer qualify for tax relief. The idea is to encourage investment in genuinely entrepreneurial companies where there is a significant risk of loss of capital.

This is not so unreasonable given the generous tax reliefs available for EIS and VCT investments. But the new condition introduces a degree of subjectivity, which depends on HMRC taking a 'reasonable view' on whether investments have been structured to provide a low-risk return for investors.


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